MAR 9 1961
JAMES R. BROWNING, Clerk

No. 357

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960

UNITED STATES OF AMERICA,

Petitioner,

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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UNITED STATES OF AMERICA,

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v.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

Opinions Below

The opinion of the District Court (R. 3) is unreported. The opinion of the Court of Appeals (R. 39-50) is reported at 279 F. 2d 152.

Jurisdiction

The judgment of the Court of Appeals was entered on May 25, 1960 (R. 51). The petition for a writ of certiorari was filed on August 23, 1960, and was granted on November 14, 1960. 364 U. S. 890 (R. 52). The jurisdiction of this Court rests upon 28 U. S. C. Sec. 1254(1).

Questions Presented

1. Whether under Section 23(c)(1) of the Internal Revenue Code of 1939, a contested real estate tax liability accrues in the year the litigation is settled (1951), or prior thereto, in the year the disputed tax is involuntarily paid (1946-1950) pending the outcome of the proceedings to reduce the tax liability.

2. Whether the right to a refund of part of the contested and involuntarily paid tax, as determined by the settlement terminating the contest, constitutes taxable income in the year of settlement (1951).

Statutes Involved

The pertinent provisions of Sections 23(c)(1), 41, 42(a), 43 and 48(c) of the Internal Revenue Code of 1939[1] are set forth in Appendix I, pp. 53-54, *infra*.

Statement

This case is not, as the Government states (Br. 8-9), one where a taxpayer "pays a local property tax assessment under protest, and then sues to recover part of the payment"; it is a case where a taxpayer denies and contests an assessed valuation of its real property and, while the contest is pending, involuntarily pays the asserted tax liability resulting therefrom, because, as the Government admits (Br. 5), "it was necessary to stay the imposition of penalties and foreclosure of [the tax] liens." The two situations are not to be confused. Their difference is all important in applying the principles of income tax accrual established by this Court. It is, therefore, necessary to restate the facts with this in mind.

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[1] These provisions are the same as their counterparts in the Internal Revenue Code of 1954 and in prior Revenue Acts. Unless otherwise noted, statutory references will be made to the 1939 Code.

NOTE—Unless otherwise noted, italics in quoted matter is supplied.

The New York Law With Respect to Real Estate Taxes

Under the New York law

—the real estate tax liability for a given year[2] on a given parcel arises out of the separate actions of two municipal bodies (assessment of the value of the property by the City Tax Commission and establishment of the real estate tax rate by the City Council) which is then shown in the bills sent during the year to the owner—it is not the result of any self-assessment such as the filing of a state or federal income tax return;

—the bills thus sent are payable in two installments —½ on October 1 of the year in which the bill is sent, and ½ on April 1 of the following year;

—failure to pay the asserted tax liability when due, as billed, subjects the property to seizure and foreclosure of the tax lien, the same as a judgment lien and the only way to remove such tax lien is to pay the full amount of the installments of the tax when due, as billed;

—an aggrieved owner can contest only the assessed valuation of its property and may do so by the *exclusive* remedy provided by statute; namely, the timely filing of a prescribed protest with the City Tax Commission (by March 15) requesting reduction of the proposed valuation to a stated amount[3]

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[2] New York City is on a fiscal year basis (July 1-June 30).

[3] In *G. C. M. 25298*, C. B. 1947-2, 39 at p. 43, it is recognized that for accrual purposes "[t]he term 'contest' includes not only a contest in court • • • but a contest lodged with the tax authorities as well. (See *The Great Island Holding Corporation et al.* v. *Commissioner*, 5 T. C. 150; acq. C. B. 1945, 3)."; and more recently in Rev. Rul. 57-105, C. B. 1957-1, 193 at p. 194.

and, if unsuccessful, appealing therefrom by filing a timely petition for certiorari (by October 25) in the State Supreme Court; there is no other way to contest and obtain a redetermination of the valuation factor upon which the real estate tax liability is based and computed;

—where such a contest is conducted in accordance with the prescribed statutory procedures, the only proper and lawful real estate tax is the product of the tax rate established by the City Council and the value of the property ultimately determined in the certiorari proceedings;

—but such contest does not prevent the seizure of the property or the foreclosure of the tax lien thereon if the tax installments, as billed, are not paid,[4] as, by way of contrast, would be the case if a taxpayer sought review of a proposed income tax deficiency and filed a petition in the Tax Court which would automatically stay any further action thereon by the Commissioner. (R. 5-6, 17-18)

Agreement Of The Parties With Respect To The New York Law

The New York law, as above outlined had been one of the issues tried in the Court of Claims in an earlier suit for refund of federal income taxes for the years 1938, 1939,

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[4] Payment to prevent such seizure is considered involuntary and made under coercion. Judge Cardozo, speaking for the New York Court of Appeals in *People ex rel. Wessel Nickel & Gross v. Craig*, 236 N. Y. 100, 104, 140 N. E. 209, stated,

> "The tax becomes a lien at the time stated in the charter • • •. Payment made thereafter is not voluntary, for the menace of the lien with penalties added for delay • • • has the effect of rendering it *compulsory*. [citing cases]"

Cf. 5 *Williston on Contracts*, Sec. 1619A, pp. 4524-28 (Rev. Ed. 1937).

and 1941 which the Government admits (Br. 20) "was identical to this one, except that it involved different taxable years".[5] Nevertheless, these facts, which were fully set out in the claim for refund attached to the complaint herein (R. 17-18), along with other facts common to both suits, were again put in issue by the Government by the qualified admissions and specific denials in its answer (R. 36). After the District Court Judge, in connection with an earlier motion of the Government, had expressed the belief that the case presented no real factual issue,[6] the stipulation was entered into which amended the pleadings "to eliminate all issues of fact" and "to raise the sole issue of law" as stated at p. 2, *supra* (R. 4, § 3).

Respondent's Contest and Settlement Of The Assessed Valuations for 1946-1950 And The Involuntary Payment Of The Asserted Real Estate Tax Liabilities

In each of the years 1946-1950, Respondent duly contested the assessed valuations on some of its hundreds of parcels of New York City real estate by complying with the above-mentioned requisites of the exclusive statutory remedy, i.e., by filing timely *bona fide* protests with the City Tax Commission requesting reduction of the valuations of those parcels to the amounts therein stated to be their true value; and, after the requests were denied, by appealing therefrom in duly instituted "certiorari proceedings" in the New York Supreme Court for the judicial review of the contested assessed valuations (R. 5-6, 17-18, 21-22). Each petition in those proceedings, as required by New

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[5] See findings numbered 6-13, *Consolidated Edison Co. of New York* v. *United States*, 133 C. Cls. 376, 386-389. The citation used by the Government (135 F. Supp. 881) does not contain the Court's findings of fact.

[6] *Consolidated Edison Company of New York* v. *U. S.*, 162 F. Supp. 854, 856, fn. 4.

York law, set forth, as did the protests, the claimed value of each parcel, which value became the minimum value the Court could find (R. 6, 18). Thus the petition, *in effect*, admitted liability for the pro rata amount of the asserted tax and denied liability for the remainder; and the litigation, *in effect*, was confined to a determination of Respondent's real estate tax liability in excess of the amount thus admitted.

Respondent involuntarily paid under protest in each of the years in question the total amount of each installment of the asserted real estate tax liability. Payment was necessary to avoid seizure of the property by foreclosure of the tax liens. But by its protest, Respondent denied and contested its liability for the unadmitted portion of the tax and reserved all rights with respect thereto.[7] (R. 6, 9, 21). In 1951 the certiorari proceedings were settled, and the court entered orders thereon, reducing the contested assessed valuations but not to the extent originally claimed by Respondent. Whereupon the City refunded the resultant overpayment of taxes (R. 7, 9, 22).

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[7] The Government admits (Br. 5) that "payment was not a requisite to judicial review in the form of prescribed certiorari proceedings", yet it constantly refers to the certiorari proceeding as refund suits (Br. 8, 21, 22, 23, 27, 29).

For a sample of the protest which accompanied the payment, see Finding No. 17 in the Court of Claims decision of the *Consolidated Edison* case (133 C. Cls. at p. 391). These are the protests which the Government stresses and repeatedly cites in its brief. They are not required under the New York law and their only significance in the present case is to eliminate any possible inference that the payments indicated an intent to discontinue the pending contests of the disputed assessed valuations. The significant protests, which the Government ignores, are those required to be filed with the City Tax Commission. See pp. 3-4, *supra*; and pp. 20-21 and fn. 30, *infra*.

The Illustrative Example

To facilitate consideration of the questions presented, the parties have agreed upon, and the Court below adopted, the following illustrative example[8] (R. 10, 42) which is also set forth in Petitioner's brief, pp. 5-6:

(a) For the year 1949 plaintiff [Respondent] was notified, on January 25, 1949, of a tentative assessment in the amount of	$100.
(b) plaintiff duly filed by March 15, 1949, a *bona fide* protest, admitting a liability of	85.
and petitioning for an administrative reduction of said tentative assessment by	15.
(c) after hearing duly held and on or about May 25, 1949, final assessment was made in the amount of	100.
(d) thereafter on or about October 1, 1949, under protest and for the stated purpose of avoiding liens, seizures, levies, penalties, interest, etc., and reserving all rights, payment was made of..	100.
(e) on October 25, 1949, certiorari proceedings were duly instituted in the New York Supreme Court admitting liability of, and denying liability in excess of	85.
(f) in December 1951, the certiorari proceedings were settled, fixing the tax liability at	95.
and establishing an overpayment which was duly refunded, in the amount of	5.

Chronology of Disagreement Over Treatment of the Unadmitted and Contested $15.

Respondent, on a similar set of facts with respect to the years 1938, 1939 and 1941, was in disagreement with the Commissioner of Internal Revenue and was actively

[8] The discussions in both Petitioner's and Respondent's briefs are in terms of this illustrative example.

contesting his income tax treatment of the difference between the total asserted tax liability ($100) and the amount of Respondent's admitted liability ($85) in each of those years, referred to at pp. 4-5, *supra*. Respondent had maintained, with respect to the earlier years, as it does in the present case, that denial and contest of a tax liability bars accrual of the amount in contest for federal income tax purposes until the contest is resolved; and, therefore, in terms of the illustrative example,

(1) only $85, which it admitted to have been properly assessed, accrued and was deductible in the year of assessment, and

(2) of the unadmitted and contested $15,

(i) the $10 ultimately determined by the settlement to have been properly assessed, accrued and was deductible in the year of settlement; and

(ii) the $5 ultimately determined by the settlement to have been improperly assessed, and which was refunded, did not constitute taxable income, but was the return of an item which had no income tax consequence from the very beginning. Under the annual accounting principle of our income tax laws, the erroneous allowance of a deduction for the $15 in a prior year did not warrant taxing the $5 as income in the year of refund.

The Commissioner had ruled that Respondent was required to deduct $95 in each of the years 1938 and 1939 when the payments were made[9] but nevertheless was required to include the $5 refund in its gross income for

[9] This reflected the Commissioner's position in I. T. 3491, C. B. 1941-2, 177, that regardless of the delay in determining a contested tax liability, it accrues and is deductible only in the year for which it was imposed.

1941.[10] The correctness of these conflicting rulings[11] was put in issue in the aforementioned refund suits filed in the United States Court of Claims for the years 1938, 1939, and 1941 (R. 20-21).[12]

When Respondent filed its income tax returns for the years 1946 through 1951, it was still engaged in its contest with the Commissioner in regard to the income tax treatment of the $15 for the years 1938, 1939 and 1941. Nevertheless, Respondent complied with the instructions it had received from the Commissioner (*G. C. M. 25298*) regarding such treatment. In terms of the illustrative example, Respondent for each of the years 1946-1950, inclusive, took deductions of $100, instead of the $85 it believed was properly deductible; and for the year 1951—the year the New York City tax liability dispute was settled—Respondent failed to take the $10 deduction it believed was proper and included in its gross income the New York City refund of $5, which Respondent believed did not constitute income. This resulted in Respondent paying less federal income taxes for the years 1946-1950 and more federal income taxes for 1951, than it believed should have been paid.[13] In due course, Respondent filed its claim for refund of 1951 income taxes

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[10] This ruling was later published as *G. C. M. 25298*, C. B. 1947-2, 39, on the basis of which *I. T. 3491* was revoked. *I. T. 3863*, C. B. 1947-2, 141.

[11] For the chronology of the Commissioner's conflicting and changing positions in this area, see Appendix III, pp. 58-61, *infra*.

[12] When these earlier suits came up for argument in 1955, the Government contended, as it does in the present case, that (1) the entire $100 was deductible in the year of payment, and (2) the $5 refund was taxable income in the year of settlement.

[13] Should the Company succeed in obtaining a refund of the 1951 taxes, the Commissioner will have one year after entry of judgment herein to reaudit the Company's 1946-1950 returns and assess deficiencies based upon deductions already taken in those years with respect to the $15, in accordance with the provisions of Sections 1311-1315 of the Internal Revenue Code of 1954.

on February 10, 1955, based upon the position it had always maintained[14] as above set forth (R. 18-24); and the claim was rejected on March 28, 1955[15] (R. 15). On December 6, 1955, the Court of Claims decided the 1938-1941 refund suits in favor of the Government. *Consolidated Edison Company of New York, Inc.* v. *United States*, 133, C. Cls. 376; cert. den. 351 U. S. 909. Thereafter, the complaint in the present suit was filed in the United States District Court for the Southern District of New York on June 6, 1956; the District Court, on cross motions for summary judgment, granted the Government's motion (R. 3); and the Court of Appeals reversed, granting Respondent's motion, Swan, J. and Lumbard, C.J. (R. 39-47), Clark, J. dissenting (R. 47-50).

Summary of Argument

POINT I

Notwithstanding Respondent's obligation, under New York Law, to pay the contested $15, the denial and contest of that liability made it contingent, non-accruable and non-deductible, under Section 23(c)(1), until the litigation ended in 1951. *Dixie Pine Products Co.* v. *United States*, 320 U. S. 516. The "precise nature" of the interim involuntary payment of the $15 and its treatment for income tax purposes, had to await the outcome of the litigation. *Consolidated Edison Co.* v. *United States*, 279 F. 2d 152; *Doyle* v. *Commissioner*, 110 F. 2d 157; *Ralph A. Boatman*, 32 T. C. 1188; *The Dill Co.*, 33 T. C. 196 (appeal pending, C. A. 3). Only then, under the "all events" rule of *United States* v.

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[14] The Government incorrectly implies that it was Respondent, not the Commissioner, that had changed its position on this question. (Br. 6, 7 fn. 1, 12)

[15] On May 9, 1955, the Commissioner rejected an amended protective claim for refund based on a matter which was eliminated by the stipulation (Par. 1(b), R. 4).

Anderson, 269 U. S. 422, did the event occur to warrant accrual and deduction of $10. *Dixie Pine, supra*, at p. 518; *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, 286-87. The annual concept of our income tax laws require that the settlement of the contest be reflected in 1951, the year of settlement. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *Security Mills, supra.*

POINT II

The legal principles of accrual, as set forth in Point I follow the Congressional intent that, absent countervailing administrative or revenue protection considerations, the accounting provisions of the Code be in accord with recognized commercial principles of accrual accounting. *Anderson*, 269 U. S. at p. 424; *Lewyt Corp.* v. *Commissioner*, 349 U. S. 237, 242-43.

Sound administration and solicitude for the revenue support, rather than militate against, the congruency between the legal principles and the commercial principles of accrual, in the present case. *Consolidated Edison Co.* v. *United States*, 279 F. 2d 152 (R. 46-47); cf. *Bressner Radio Inc.* v. *Commissioner*, 267 F. 2d 520, 528.

The Government's reliance upon its administrative ruling in *G. C. M. 25298*, C. B. 1947-2, 39, is an attempt to raise itself by its own bootstraps—for that ruling was issued to respondent on the very question now before this Court—and ignores the modification thereof in *Mim. 6444*, C. B. 1949-2, 11, that payment *per se*, i. e., payment of a contested tax "which is a prerequisite for further appeal"—is not a basis for accrual. There has been no uniform administrative construction on this question and the present rulings thereon are contradictory.

POINT III

The decisions of the Court of Claims in *Chestnut Securities Co.* v. *United States*, 104 C. Cls. 489, 62 F. Supp. 574, and *Consolidated Edison Co.* v. *United States*, 133 C. Cls. 376, 135 F. Supp. 881, upon which the Government relies, are contrary to the principles of accrual established by this Court.

The *Chestnut Securities* doctrine of the Court of Claims that "accrual precedes payment and does not survive it", was based upon that court's belief (1) that it was within the meaning of the tax laws,—a belief rejected by this Court in *United States* v. *Olympic Radio & Television Co., Inc.*, 349 U. S. 232, and (2) that it was within the terminology of accounting—a belief on which the Court of Claims reversed itself in its decision of the *Consolidated Edison Company* case. Appendix II, pp. 55-57, *infra*. The doctrine that "payment of an item which is otherwise accruable in the taxable year, accrues the item", which the Court of Claims enunciated in the *Consolidated Edison Company* case, is contrary to the principles of accrual established by this Court.

In complete disagreement with the Court of Claims are the decisions of the court below (R. 39-47), *Consolidated Edison Co.* v. *United States*, 279 F. 2d 152, cited with approval in *Schlude* v. *Commissioner*, 283 F. 2d 234, 238, pet. for cert. filed Jan. 4, 1961; and *Standard Oil Co. of Ohio* v. *United States*, 51 AFTR 1688, 56-2 USTC (CCH) Par. 10051.

The Government's assertion that the Tax Court has followed the Court of Claims, is not supported by the cases it cites.

POINT IV

It follows from Point I that the $5 refund is not taxable income in 1951. The annual accounting system of our income tax laws does not permit correction of the erroneous allowance of the $15 deduction in 1949, now closed by the statute of limitations, by including the $5 refund in Respondent's income for 1951. *McEachern* v. *Rose*, 302 U. S. 56, 62; *Commissioner* v. *Dwyer*, 203 F. 2d 522, 524-25; *Streckfus Steamers, Inc.*, 19 T. C. 1. Any relief or remedy available to the Commissioner with respect to the erroneous $15 deduction in 1949 is specifically provided for in Sections 1311-1315 of the Internal Revenue Code of 1954. Thereunder, the Commissioner will have one year after a decision herein in favor of the Respondent becomes final, within which to review the deduction of the $15 in Respondent's 1949 return and to assert a deficiency with respect thereto, in accordance with the provisions of said Sections 1311-1315.

ARGUMENT

POINT I

Under established principles of income tax accrual, the amount of a contested tax liability is contingent and non deductible under Section 23(c)(1) until the litigation is ended; an involuntary, compulsory payment thereof pending the outcome of the litigation does not, as a matter of law, accrue the amount as a deduction at the date of payment.

The deduction granted by Section 23(c)(1) for "[t]axes paid or accrued within the taxable year * * *" permits an accrual basis taxpayer to take the deduction only for taxes *accrued*—and not for taxes *paid*—within the taxable year.

United States v. *Olympic Radio & Television Inc.*, 349 U. S. 232; *Lewyt Corporation* v. *Commissioner*, 349 U. S. 237.

Although payment may be germane as evidence of an admission of liability which, in turn, would be a basis for accrual, that is not the situation here. (R. 5-6)

The question in the present case is solely one of law—whether payment, *per se*, accrues a contested tax liability. We submit that, under the principles of income tax accrual established by this Court, the involuntary, compulsory payment of the unadmitted and contested $15 tax liability did not, *as a matter of law*, accrue that liability in 1949; and that $10 thereof first accrued when the litigation ended in 1951.

Income Tax Accrual is a "Technical Concept"—"All Events Rule" of *Anderson*

Accrual under the income tax laws is a "technical concept"; it "embodies the annual accounting principle"; and "is to be determined in accord with normal accounting concepts relevant to the accrual basis."[16] The application of this "technical concept" to Section 23(c) has its roots in what is commonly referred to as the "all events rule",—that for a tax liability to accrue "* * * all the events may [must] occur which fix the amount of the tax and determine the liability of the taxpayer to pay." *United States* v. *Anderson*, 269 U. S. 422, 441;[17] *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516, 519; *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, 284.

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[16] *Lewyt Corporation* v. *Commissioner*, 349 U. S. 237, 242-43.

[17] The "all events" rule is also applicable in the accrual of gross income (*Spring City Foundry Co.* v. *Commissioner*, 292 U. S. 182, 184) and non-tax deductions (*Brown* v. *Helvering*, 291 U. S. 193).

"Contested Tax Liability Test" of *Dixie Pine*—Another Facet of the All Events Rule

The "all events" rule posed no problem where, as in *Anderson*, the tax liability was admitted and uncontested;[18] but differences arose where the tax liability was denied and contested. On the one hand, it was maintained that the denial and contest of a *tax* liability made it contingent and dependent upon the outcome of the litigation,[19] just as in the case of an unadmitted and contested *non-tax* liability.[20] On the other hand, it was maintained that a different rule applied to a contested *tax* liability—that by virtue of the obligation created by the tax imposing statute, all events had occurred to fix the liability in the year *for* which the tax was imposed.[21] Between these two contentions were numerous conflicting exceptions and distinctions.[22] The

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[18] In such a situation the tax liability "confessedly accrued". *Lucas* v. *American Code Co.*, 280 U. S. 445, 452.

[19] *Dixie Pine Products Co.* v. *Commissioner*, 134 F. 2d 273.

[20] *Lucas* v. *American Code Co., Inc.*, 280 U. S. 445.

[21] *Davies' Estate* v. *Commissioner*, 126 F. 2d 294; *J. A. Dougherty's Sons, Inc.* v. *Commissioner*, 121 F. 2d 700; *Commissioner* v. *Central United National Bank*, 99 F. 2d 568.

[22] Originally, an unconstitutional tax statute was deemed a nullity (*Norton* v. *Shelby County*, 118 U. S. 425, 442) and could not serve as a basis for a *tax* deduction; but a payment thereunder might be claimed as a *loss*. *E. L. Bruce Co.*, 19 B. T. A. 777. Later, such a statute was considered an operative fact (*Chicot County Drainage District* v. *Baxter State Bank*, 308 U. S. 371, 374), which could be taken into consideration for accrual purposes until declared invalid. *Cartex Mills, Inc.*, 42 B. T. A. 894. Conflicting views arose as to whether the determination of unconstitutionality in a later year called for adjustment in the year for which the tax was imposed, or in the year the law was declared invalid. Some inquired whether the taxpayer could be "made whole" in the earlier year. Others disregarded the "made whole" theory and held that, subject to the statute of limitations, adjustment should be made in the year for which the tax was imposed. See review of some of the cases in *E. B. Elliott Co.*, 45 B. T. A. 82, 87-93, and the dissenting opinions, pp. 95-96. These views also cut across cases involving a contested liability under a valid tax law.

Commissioner, uncertain as to which of the conflicting theories to adopt, changed his official position, from time to time;[23] and even then failed to follow such position when, in a given instance, it was to the interest of the revenue not to do so.[24] As a result he found himself taking inconsistent positions not only with respect to different taxpayers but even with respect to the same taxpayer.[25]

Out of this confused background arose *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516. There, the taxpayer denied and contested its liability for a Mississippi tax and did not pay the tax. Nevertheless, it sought to accrue and deduct the tax liability under Section 23(c). Addressing itself to the underlying cause of the prevailing confusion, this Court held that the denial and contest of liability under a tax statute was the critical fact which prevailed over the interim obligation created by the statute;—that notwithstanding such statutory obligation, the contest made the tax liability contingent, non-accruable and non-deductible under Section 23(c), until the contest was terminated, saying (p. 519):

> "It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid; and this cannot be the case where the liability is contingent and is contested by the taxpayer."

And in answer to the contention that a different rule should be applied to contested *tax* liabilities, this Court continued:

> "Here the taxpayer was strenuously contesting liability in the courts and, at the same time, deducting

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[23] The published rulings reflecting the various changes of the Commissioner are set forth in Appendix III, pp. 58-61, *infra*.

[24] E. g., *Lehigh Valley Railroad Co.*, 12 T. C. 977, 997-998 and fn. 2, p. 998.

[25] See pp. 8-9 *supra*, where the Commissioner took inconsistent positions with respect to Respondent for the years 1938-1941.

> the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability. This it could not do. It must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated."

The Government argues that, by use of the phrase "though not paid" in the first of the above-quotations, this Court stressed the non-payment of the disputed tax and made it a prerequisite for non-accrual. (Br. 18-19) When read in context, however, it is obvious that the contrary is true; that in rejecting the taxpayer's argument that payment of the tax is the basis for accrual, this Court considered payment an irrelevant factor—that a tax may accrue *even though* it is not paid; and, as the second quotation shows, this Court did not mean that payment of a tax under protest as an unavoidable incident of contesting liability, would fix liability.

Dixie Pine and *Anderson* complement each other as different facets of the "all events" rule. Where the tax liability is admitted or uncontested, all events have occurred to fix the liability to warrant accrual and deduction under Section 23(c). But where the tax liability is denied and contested, the event fixing the liability first occurs when the contest is ended; until then the tax liability is contingent and is not accruable or deductible under Section 23(c).

The Government, in the present case, would revive the contention (clothed in a somewhat different garb) which *Dixie Pine* rejected. It would ignore the denial and contest of the tax liability and would emphasize Respondent's involuntary payment of the amount of the tax it was contesting as the critical accrual event—just as in *Dixie Pine* the taxpayer sought to ignore the denial and contest of the tax liability and emphasized the obligation created by the tax imposing statute as the critical accrual event. But Respondent's involuntary payment of the contested $15—that is, the

$15 over and above the $85 which it admitted it owed—was made under compulsion or duress and did not terminate the contest.[26] In the language of *Dixie Pine*, it was still necessary "in the circumstances, [to] await the event of the State court litigation" to ascertain the amount, if any, of the contested liability. Under *Anderson* and *Dixie Pine*, the settlement in 1951 was the accrual event which, for the first time, "fixed" the contested $15 liability at $10.

Payment of a Contingent Liability Does Not Accrue Such Contingent Liability as a Deduction

The Government's contention that payment, *per se*, is a basis for accrual, would eliminate the fundamental distinction between cash and accrual basis taxpayers and would put an accrual basis taxpayer on "a divided and inconsistent method of accounting not properly to be denominated either a cash or an accrual system". (*Security Mills*, 321 U. S. at p. 287). Contrary to *Olympic Radio* and *Lewyt*, it would also change the meaning of Section 23(c) and grant a deduction to cash basis taxpayers for "taxes paid", and to accrual basis taxpayers for "taxes paid or accrued".

Moreover, it misconceives the rationale of *Dixie Pine*. Under that rationale the denial and contest of liability for the $15 made that liability contingent, non accruable and non deductible under Section 23(c) until the contest ended. Respondent's interim involuntary payment of that contingent $15 liability did not end the contest or fix the amount of the contested liability. (p. 4, *supra*). As stated by the Court below, per Swan, J. (R. 45):

> "A payment may constitute a capital expenditure, an exchange of assets, a prepaid expense, a deposit or a current expense. When the exact nature of the payment is not immediately ascertainable because it depends on some future event, such as the out-

[26] See p. 4 *supra*.

come of litigation, its treatment for income tax purposes must await that event." *Consolidated Edison Co. v. United States*, 279 F. 2d 152, 156.

Similarly, *Doyle* v. *Commissioner*, 110 F. 2d 157. Cf. *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U. S. 130, 133;[27] *Ralph A. Boatman*, 32 T. C. 1188; *Dill Co.*, 33 T. C. 196. The "precise nature" and character of the payment is determinative of its income tax treatment.[28]

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[27] "• • • if is necessary to determine the *precise nature* of the property taken" to determine its tax treatment.

[28] For the different tax treatment of different types of payments, see also *Commissioner* v. *Boylston Market Assn.*, 131 F. 2d 966, 968, where an insurance premium payment covering more than one year was considered a capital expenditure rather than a current expense (overruling the court's contrary decision in *Welch* v. *DeBlois*, 94 F. 2d 842), and *Waldheim Realty & Inv. Co.* v. *Commissioner*, 245 F. 2d 823, 824, where such insurance premiums payments were considered a current expense (in agreement with *Welch* v. *DeBlois*, *supra*); *R. D. Cravens*, 30 T. C. 503, where payment for feed to be delivered the following year was considered a deposit rather than a current expense; the reversal of that case in *Cravens* v. *Commissioner*, 272 F. 2d 895; and *John Ernst*, 32 T. C. 181, where a payment for feed to be delivered the following year was considered a current expense rather than a deposit; *Veenstra & DeHahn Coal Co.*, 11 T. C. 964 and *Federal Machine & Welder Co.*, 11 T. C. 952, 1956 where receipts were considered deposits for future sales rather than current income; *Richard M. Drachman*, 23 T. C. 558 where the payment was considered a loan rather than a business expense or capital contribution; *Unitex Industries, Inc.*, 30 T. C. 468, payments to subscribers of preferred stock during the period of installment payments on account of the subscriptions were considered payments to stockholders rather than payments of interest or expense; and *Rev. Rul. 59-184*, 1959-1, C. B. 65, 68, where premium payments on the lives of two principal stockholders were considered an exchange of assets, cash for insurance policy, rather than a dividend distribution.

In the *Doyle* case, the "precise nature" of the forfeited payments received under an executory real estate sales contract, and their treatment for income tax purposes, was determined and reflected in the year of forfeiture—not in the earlier year of receipt. In the present case, the payment of the contested $15 no more characterized it for income tax purposes than did the initial payments in the *Doyle* case. It was still necessary, under *Anderson, Dixie Pine* and *Doyle*, to await the outcome of the contest to determine the "precise nature" of the payment and its treatment for income tax purposes.

Nor does the Government's argument (Br. 21-22, 26-30) that payment extinguished the liability bring it closer to accrual under Section 23(c). Payment of the amount of the non contested tax liability ($85) extinguished a liability that was fixed and deductible for income tax purposes. But the statutory protest and denial of liability for $15 of the asserted liability, and the institution of the certiorari proceedings to enforce the validity of its protest rendered that portion of the asserted tax liability contingent and non deductible, under *Dixie Pine*, until the precise amount of that additional liability, if any, had been determined. Until then the payment of the disputed amount had no income tax consequence; it merely exchanged one asset (cash) for another (a deposit, deferred expense or other account receivable.)[29]

The Government's reliance upon *Rosenman* v. *United States*, 323 U. S. 658, and *Lewyt Corp.* v. *Commissioner*, 215 F. 2d 518 (Br. 27-29), shows that it regards the New York system of taxing real estate similar to the Federal system of taxing income and decedent estates. In fact, the two systems are fundamentally different, particularly in

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[29] For the treatment of such payments under recognized principles of accrual accounting, see Appendix II, pp. 56-57, *infra*.

matters of accrual. The tax liability under the Federal systems arises out of an "assessment" which cannot take place (except in the extraordinary case of a jeopardy assessment) without the express or tacit consent of the taxpayer, i.e. by way of self assessment on the filing of a return or failure to oppose a proposed deficiency by failing to file a petition in the Tax Court. Such express or tacit consent, under *Anderson*, is a proper basis for accrual. The tax liability under the New York system, however, arises, not out of any such "assessment" of tax, but out of the actions of two separate municipal bodies (see p. 3, *supra*) regardless of the taxpayer's consent or opposition. The asserted tax liability may be enforced by virtue of the City's power of distraint, notwithstanding the taxpayer's opposition thereto or the pendency of New York certiorari proceedings, duly instituted by the taxpayer to review the correctness of the assessed valuations upon which the asserted tax liability was computed.[30] The contest of the asserted real estate tax liability by compliance with the State statutory require-

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[30] See p. 4, *supra*. As stated in fn. 7, p. 6, *supra*, the state certiorari proceedings would have been maintainable, and could have been prosecuted, even if the real estate tax bills issued by the City had not been paid. There is no suit available for the refund of New York City real estate taxes, such as there is for the refund of Federal estate or income taxes (*U. S. Trust Co.* v. *Mayor, etc. of New York*, 144 N. Y. 488, 39 N. E. 383; *Swift* v. *City of Poughkeepsie*, 37 N. Y. 511); or for any method of reviewing the assessed valuation of the property involved other than by the exclusive certiorari proceedings provided by the New York statutes. *Sikora Realty Corporation* v. *New York*, 262 N. Y. 312, 186 N. E. 796, rearg. den. 262 N. Y. 636, 188 N. E. 99; *Nat Friedman & Son, Inc.* v. *New York*, 262 N. Y. 665, 188 N. E. 112; *New York Central Railroad Co.* v. *Limburg*, 261 App. Div. 562, appeal denied 262 App. Div. 746, appeal dismissed 286 N. Y. 605, 35 N. E. 2d 942; *People ex rel. Staten Island Rapid Transit Co.* v. *Taylor*, 247 App. Div. 405, 287 N. Y. S. 456; *Young Women's Christian Association* v. *New York*, 217 App. Div. 406, affd. 255 N. Y. 562, 157 N. E. 858.

ments (see pp. 3-4, *supra*) would under *Dixie Pine*, make that asserted liability contingent and non accruable until the end of the contest. Only recently, this Court took cognizance of this distinguishing characteristic of the Federal System in various systems of taxation, when it stated, "Our system of [federal income] taxation is based upon voluntary assessment and payment, not upon distraint", *Flora* v. *United States*, 362 U. S. 145, 176, citing *Helvering* v. *Mitchell*, 303 U. S. 391, 399.[31]

The essential point of the Government's argument appears to be in the statement (Br. 29), "The taxes had already been assessed by the City * * *. Taxpayer was left with only a claim for refund which might or might not materialize in a later year." From this premise the Government argues that the decisions in *Rosenman* and *Lewyt*, *supra* (p. 20), support its position that the unadmitted and contested $15 accrued when it was involuntarily paid pending the outcome of the contest.

But, as we have already shown, this premise misconceives the true nature of liability under the New York system of taxation—and neither the *Rosenman* nor the *Lewyt* decision supports the Government's position. The *Rosenman* case did not involve any question of accrual. It involved only the application of the statute of limitations on refund claims. The refund claim, which is the foundation for the action at law to recover alleged excess tax payments, was filed in 1940. This was more than three years following the remittance in 1936, which was placed in a Suspense Account, and within three years of the date the taxes were

[31] The division of opinion in the *Flora* case was not addressed to this observation but to the proper path to be followed from that point; namely, whether or not, after the assessment is made, it is necessary that it be paid in full before a refund suit may be commenced.

assessed and paid by application of the monies thus remitted. As this Court stated in that case (323 U. S. at p. 661), "It is this erroneous assessment that gave rise to a claim for refund. Not until then was there such a claim as could start the time running for presenting the claim. In any responsible sense *payment* was then made by the application of the balance credited to the petitioners in the suspense account and by the additional payment of $10,497.34 on April 22, 1938." Under the self assessment concept of the Federal estate tax laws, there can be no such assessment without the express or tacit approval of the taxpayer. The Government attempts to bring the present case under the *Rosenman* decision by arguing that payment of the $15 was "in discharage of an asserted tax liability". (Br. 29) Completely ignored is the fact that the payment of the $15 was the payment of a *contingent* liability whereas the payment in the *Rosenman* case was the payment of a tax liability already *fixed* by the "assessment". In the present case the "precise nature" of the item paid was yet to be determined (see pp. 17-19, *supra*).

Similarly, an incidental issued decided by the Court of Appeals in *Lowyt* (which did not reach this Court), was whether remittances to the Collector in 1947 in payment of proposed excess profits tax deficiences, which were then being contested in the Tax Court, constituted "payment" of tax within the contemplation of the statute. The "assessment" of the proposed deficiences was barred because of the contests pending in the Tax Court.[32] The taxpayer, under the erroneous belief that a settlement of the contested liabilities had been effected with the Commissioner, made remittances to the Collector in 1947 in the full amount of the

[32] Section 272 specifically provides that "No assessment of a deficiency in respect of the tax imposed by this chapter and no distraint or proceeding in court for its collection shall be made, begun or prosecuted * * * if a petition has been filed with the Board, until the decision of the Board has become final."

settlement negotiation. These payments were placed in a "Suspense Account" because there were no "assessments" against which they could be credited. In 1948, a final settlement was effected and the resultant deficiences were thereupon "assessed", and the monies which, in 1947 had been remitted and placed in a Suspense Account, were then applied towards the *payment* of those "assessments".

The main issue in the case was taxpayer's claim that "paid or accrued", as used in Section 122(d)(6), could be read in the alternative to enable it, an accrual basis taxpayer, to make Section 122(d)(6) adjustments for taxes "paid" in 1947. In the incidental issue, the taxpayer conceded that it could only make Section 122(d)(6) adjustments for taxes "accrued" in 1947; but maintained that, under *Chestnut Securities*, payment of contested taxes accrued them and that the 1947 remittances which were placed in a Suspense Account constituted such payments. The Commissioner admitted that this would be true if the 1947 remittances constituted "payments" of *tax*, but maintained that they did not. Thus, the only question presented to the Court of Appeals on this point was whether the 1947 remittances constituted "payments" of *tax*. The Court held, on the basis of the *Rosenman* case, that the 1947 remittances did not constitute "payments" of the contested tax liabilities.

The self assessment system of the federal income tax law should not be confused with the distraint system of the New York City real estate tax. The focal point of the federal income tax system, like that of the federal estate tax system with which *Rosenman* was concerned, is the *assessment* of the tax. Thus, the Government's reliance in the present case upon *Lewyt* (Br. 28-29) to support its claim that satisfaction of an asserted liability constitutes a "payment" of tax ignores the fact that the Court, in *Lewyt*, was addressing itself to an asserted tax liability which becomes fixed by the assessment of the tax (which in turn could not

take place without the express or tacit approval of the taxpayer). This is made clear by the sentences in *Lewyt* which follow the passages quoted by the Government (215 F. 2d at p. 523):

> "Or it [satisfaction] may follow from the payment of an asserted liability in advance of assessment * * * *if* * * * the payment is accompanied by the taxpayer's acquiescence in the proposed deficiency. The same holds true as to § 271(a)(1)(B), 26 U. S. C. A. § 271(a)(1)(B), requiring that amounts 'collected without assessment' be excluded from the computation of a deficiency, for *here again acquiescence by the taxpayer in such collections as constituting satisfaction of part of his tax liability is a condition necessarily to be implied.* In short, *there can be no payment without satisfaction whether pursuant to or apart from an assessment.* Here the taxpayer was tendering its check with one hand, and contesting its liability to pay with the other."

If any analogy were to be drawn between the present case and the *Lewyt* case, it would be to say that the New York certiorari proceedings was similar to the filing of a petition in the Tax Court to review a proposed deficiency. The real difference between the two, however, is the underlying basis of the respective systems of taxation. Under the Federal system of self assessment the filing of such a petition automatically stayed the assessment and collection of the proposed deficiency in *Lewyt* so that there was no "assessed" tax liability which could be "satisfied"; whereas under New York system of distraint, the filing of a petition in the certiorari proceedings did not stay the collection of the tax.

In relying upon *Rosenman* and the Court of Appeals' decision in *Lewyt*, the Government avoids the real issue in this case—whether the involuntary, compulsory payment of the contested real estate tax liability pending the outcome

of the contest, *as a matter of law*, accrues the contested liability as a deduction under Section 23(c), or whether the "precise nature" of the payment must await the outcome of the contest.

Admittedly, only one half of the asserted real estate tax liability in the present case was due on October 1 of each taxable year (R. 6), which half was duly paid in that year (R. 9); and the other half was first due on April 1 of the following year and was duly paid in that following year. Yet the Government would have the "certiorari proceedings", commenced in the taxable year, deemed a "refund suit" for taxes which had not yet been paid. Moreover, the amount actually paid in the taxable year, on account of the first installment of the asserted tax liability was less than the amount which Respondent admitted it owed to the City.[33] A suit for a tax refund is for the recovery of an *overpayment of tax legally due*—it is in the nature of a common law action "in assumpsit"—and is a suit on an *accrued* right for money had and received by reason of the improper or illegal collection of an asserted tax,[34]—a remedy which has been incorporated in our federal statutes, "for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected".[35]

The "Annual Accounting Principle" Of *Security Mills*

The history and background of *Dixie Pine* indicates that its rationale was intended to be broadly applied to

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[33] In terms of the figures in the illustrative example, the Government claims that Respondent, having paid $50 on account of the asserted tax liability in October of the taxable year, by filing the petition for certiorari in the New York Supreme Court that same month, in which it in effect admitted liability for $85, thereby commenced a suit for refund when it had not yet paid the amount that it admitted it owed.

[34] See, *Elliott* v. *Swartwout*, 10 Pet. 137; *Philadelphia* v. *Collector*, 5 Wall. 720; *Lowe Bros. Co.* v. *United States*, 304 U. S. 302; *Kings County Savings Institution* v. *Blair*, 116 U. S. 200; *Rock Island A. & L. R. R. Co.* v. *United States*, 254 U. S. 141.

[35] 28 U. S. C. § 1346 (a)(1)

eliminate the confusion which the various distinctions and exceptions had created. That rationale made it unnecessary for this Court to pass upon the Government's alternative argument in that case; namely, that in any event the Commissioner could relate back to the taxable year, and reflect therein, the ultimate result of the litigation which ended in the later year.[36] The last sentence in the quotation from *Dixie Pine, supra* (p. 16)[37] answered this alternative argument and presaged the decision rendered a few weeks later in *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, which refused to permit the "transactional" approach and upheld the "annual accounting principle" established by this Court in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359.[38]

The Government quotes at length from *Security Mills* (Br. 18) to support its claim that only unpaid contested taxes are not accruable. The history of that case[39] contradicts this claim. The non-payment of the tax in *Security Mills*, as in *Dixie Pine*, was not a factor in its determination.

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[36] See Point II of Government's Brief in *Dixie Pine*—October 1943 Term, No. 84. In that case, the taxpayer's denial and contest of liability for the Mississippi tax had been decided ultimately in taxpayer's favor. The Government argued, alternatively, that by relating back that ultimate determination of no liability to the taxable year, there was no State tax liability in the taxable year for which the taxpayer could take a deduction under Sec. 23(c).

[37] "It must, in the circumstances, await the event of the State Court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated."

[38] The *Security Mills* case "has nevertheless been mistakenly regarded on occasion as identical in issue and resolution to such cases as *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516, which have held that accrual taxpayers who refuse to pay taxes on the ground of their invalidity may not accrue and deduct the liability to pay them during the course of the dispute". *Bressner Radio Inc.* v. *Commissioner*, 267 F. 2d 520, 528.

[39] "Upon this point a page of history is worth a volume of logic." Mr. Justice Holmes in *New York Trust Co.* v. *Eisner*, 256 U. S. 345, 349.

The taxpayer, in *Security Mills,* on the annual accrual basis, paid during the first four months of 1935 the monthly AAA taxes imposed upon it as a first domestic processor of wheat; and then refused to pay these taxes for the balance of the year. In a suit to enjoin their further collection, it obtained a temporary injunction upon condition that it continue to file monthly AAA information returns and pay the tax therein disclosed, to a designated depository; which it did.

In determining the lump sum price of the flour to be charged its customers, the taxpayer included the AAA tax as part of its cost (which for illustrative purposes will be assumed to be 5¢ per barrel). The sales were made under a uniform miller's contract which provided for adjustment in price to reflect any increase or decrease in taxes; but when the AAA was declared unconstitutional on January 6, 1936 and the monies paid to the depository were returned to it, the taxpayer maintained that this clause was inapplicable. Nevertheless, it did make refunds of 3¢ per barrel to some of its customers in 1936, 1937, and 1938.

In its 1935 federal income tax return, the taxpayer accrued and deducted under Section 23(c) both the AAA taxes it paid the Collector during the first four months—which the Commissioner allowed—and the AAA taxes it refused to pay the Collector during the balance of the year but had paid to the depository under the injunction order—which the Commissioner disallowed. As to the latter, the taxpayer argued: (1) the 5¢ per barrel should be excluded from gross income because it represented the AAA tax transmitted to it by its customers for payment to the Collector; (2) even if the 5¢ were includible in gross income, taxpayer became obliged, under the miller's contract, to repay it when the AAA was declared unconstitutional, and (3) in any event, the 3¢ refunded to its customers in 1936-1938 was (under Section 23(a)) an ordinary and necessary expense of its sales in 1935 and should (under Section 43) be related back to 1935 "in order to clearly reflect income" of that year.

The Board of Tax Appeals sustained only the last of the taxpayer's contentions.[40] The Commissioner—not the taxpayer—appealed from this determination, which brought up only the question of relating back the refunds of 3¢ in 1936-38 to 1935 as expenses under Section 23(a).[41] The Court of Appeals reversed and held that the taxpayer may not relate back to 1935 the events which occurred in 1936-1938.[42] This was the only issue in the taxpayer's appeal to this Court, as was acknowledged by the Court itself.[43]

When taken in this context, it is clear that the Government's quotation from *Security Mills* (Br. 18) was part of the recital of the background of the case to establish the fact that the disputed and unpaid AAA taxes were part of the purchase price received by the taxpayer on the sales of flour in 1935 and that these were the sales—the transactions—to which the taxpayer sought to relate back the refunds made to its customers in 1936-1938. This Court had at the beginning pointed out that the amounts of the AAA taxes which were paid during the first 4 months of 1935 were not involved. A reading of the entire decision does not sustain the Government's assertion that this Court in *Security Mills* "stressed that the liability there involved had not been paid" (Br. 18-19). This Court's reference to the AAA tax "not paid to the Collector" and which the taxpayer "failed to pay" could more reasonably be ascribed to distinguishing the taxes paid during the first four months, which were not before this Court, from the unpaid taxes of the remaining 8 months, which were before this Court.

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[40] *Security Flour Mills Co.*, 45 B. T. A. 671.

[41] The taxpayer appealed from the Board's decision with respect to the income tax treatment of the refund of the AAA taxes paid during the first four months of 1935 and was sustained by the Court of Appeals.

[42] *Security Flour Mills Co.* v. *Commissioner*, 135 F. 2d 165.

[43] *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, 283. "The propriety of the claimed deduction depends upon the construction of §§ 23(a), 41 and 43 of the Revenue Act of 1934."

It was generally believed that *Dixie Pine* and *Security Mills* had rounded out the "all events" test of *Anderson*. The Commissioner, nevertheless, sought to restrict their application when it was in the interest of the revenue to do so, and continued to argue that a distinction should be drawn between relating back the events affecting a *non-tax* liability to the year of the original transaction (which *Security Mills* held may not be done) and relating back the outcome of a contested *tax* liability to the year for which the tax was asserted (which the Commissioner claimed in *Dixie Pine* should be done). But this attempt proved unsuccessful. *Stanard-Tilton Milling Co.*, 3 T. C. 1026, 1029-30 (Second Issue).[44]

The Government's attempt in the present case to restrict the contested liability rule of *Dixie Pine* to unpaid contested taxes is of a similar character. It also seeks to revert back to the fragmentation of the accrual concept which had occurred before *Dixie Pine* and *Security Mills*, and is a further contribution to the existing "jungle" in the accounting area of income tax law.[45]

Finally, the Government misconceives, or misapplies, the "transactional" theory when it states (Br. 22) that Respondent urges, contrary to *Security Mills*, a "transactional" treatment of items of income and expenses. Respondent's position is directly contrary to the "transactional" approach in that Respondent urges the deduction of the $10 in 1951 when the contested and contingent tax liability became fixed, and does not seek to relate back the deductions to 1949, the year *for which* the tax was imposed, as did the taxpayer in *Security Mills*.

It should be noted in conclusion of this Point that even the dissenting opinion of Judge Clark, in the court below,

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[44] The Commissioner first non acquiesced in that decision. C. B. 1944, 48. Not until about 5 years later did he finally withdraw his non acquiescence and acquiesce in it. C. B. 1949-1, 3.

[45] See dissenting opinion of Judge Friendly in *Commissioner* v. *Fifth Ave. Coach Lines*, 281 F. 2d 556, 563.

does not uphold the Government's contention that this Court in *Dixie Pine* and *Security Mills*, made non-payment a prerequisite for non-accrual. The dissenting opinion merely stated that in neither case "is there any holding that tax liabilities already paid should not be accounted for tax-wise until all disputes have somehow been put to rest" (R. 50). Of course there was no such holding—nor was there any holding, as the Government claims, that non-payment of the contested tax is a prerequisite for non-accrual. As previously noted, non-payment was only an incidental fact, and in no manner a decisive factor in the decisions of both cases.

We submit that under the principles of accrual established by this Court, the denial and contest of the disputed $15 real estate tax liability for 1949 made it contingent, non-accrual and non-deductible under Section 23(c); the involuntary payment thereof in 1949 pending the outcome of the litigation, did not accrue the contested $15, but constituted the payment of a contingent obligation which, for income tax purposes, had to await the outcome of the litigation to determine the nature and character of the payment; and the settlement of the contest in 1951 was the event which fixed the contested liability at $10 for purposes of accrual and deduction under Section 23(c).

POINT II

Respondent's position follows the congressional intent that, absent countervailing administrative or revenue protection considerations, income tax accrual should coincide with recognized principles of accrual accounting.

It is, of course, most desirable that income tax accrual concepts be in accord with recognized principles of accrual accounting. But administrative and revenue protection considerations may require income tax accounting to be

somewhat more precise and exact[46] and to be based upon objective, rather than subjective, criteria. Consequently, income tax accrual does not envisage the use of "estimates", as distinguished from "fixed" amounts, in determining income on the accrual basis.

The Congressional Intent That Income Tax Accrual Coincide With Recognized Principles of Accrual Accounting

These conflicting considerations were recognized from the very outset when this Court, in *Anderson*, stated that the accounting sections of the income tax law "indicate with no uncertainty of purpose" that "[i]t was to enable taxpayers to keep their books and make their returns according to scientific accounting principles * * *"[47] and then proceeded to establish the *legal* principles of income tax accrual which are embodied in the "all events" rule discussed at pp. 14-17, *supra*.[48] The enactment of Sections 452 and 462 of the 1954 Code was another step in the desire to bring the legal and commercial accrual concepts more closely together and to permit income tax accrual to be based upon "estimates";[49] but the realization

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[46] See "Time For Accrual of Income and Expenses" by William M. Emery, New York University Seventeenth Annual Institute on Federal Taxation, pp. 183-186 (1959).

[47] 269 U. S. at p. 440. Indeed, Section 48(e) specifically provides for the use of taxpayer's "method of accounting" in computing net income (§ 41), determining gross income (§ 42) and allowing deductions (§ 43).

[48] Scientific accounting principles not only take into consideration events which *fix* rights and duties, in determining income on the accrual basis, but also, in the absence of such "fixing events", permit *estimates* to be made for such purposes. Income tax accrual, however, is restricted to "events" which *fix* both the fact and the amount of the right or duty.

[49] See House Report No. 1337 on H. R. 8300, 83rd Cong., 2d Sess., (1954) pp. A 159, 162-163; and Senate Report No. 1622 on H. R. 8300, 83rd Cong., 2d Sess., (1954) pp. 301-303, 305-307. It should be observed that even then, Congress recognized that "Reserves created * * * for specific expenses and losses that are being *contested* or are in litigation * * * are *not* to be the basis for additions to reserves under this section." *Idem*, pp. 163 and 307, respectively.

of the tremendous revenue loss resulting from the unexpected applications of those sections prompted their retroactive repeal.[50] As stated by the Senate Finance Committee[51]:

> "Your committee desires to make its position clear that it expects to report out legislation dealing with prepaid income and reserves for estimated expenses at an early date. As indicated above, the existing rulings of the Treasury Department and the court decisions dealing with estimated expenses and prepaid income are now in such a state of confusion and uncertainty that in the opinion of your committee legislative action is required on these subjects. *In addition, your committee believes that it is essential that the income tax laws be brought into harmony with generally accepted accounting principles.* Moreover, your committee believes that the present status, where some taxpayers are able to defer prepaid income while others are not, is inequitable and should not be allowed to continue. In order to eliminate this uncertainty and discrimination, definite rules must be written into the income tax law. For these reasons your committee plans to begin studies in the near future to devise proper substitutes for the sections now being repealed."

Respondent's position in the present case is in complete accord with the recognized principles of accrual accounting;[52] and we submit, there are no countervailing administrative or revenue protection considerations to the contrary.[53]

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[50] See House and Senate Reports on H. R. 4725, 84th Cong., 1st Sess., C. B. 1955-2 at pp. 853-855 and 859-861, respectively.

[51] C. B. 1955-2, at p. 861.

[52] Appendix II, pp. 55-57, *infra*.

[53] Cf. *Bressner Radio, Inc.* v. *Commissioner*, 267 F. 2d 520, 528: "Absent an express Congressional command, a lack of congruency between the accrual methods authorized under § 41 and sound accounting practice must arise out of the demonstrable requirement of sound administration of the revenue laws."

Respondent's Position In The Present Case Accords With The Recognized Accounting Principles That Payment, *per se*, Has No Effect Upon Accrual

The recognized accounting principles on the accrual basis, applicable in the present case, were put in issue, and the Court of Claims made specific findings thereon, in *Consolidated Edison Company* v. *United States*, 133 C. Cls 376, 397-398,[52] the very case upon which the Government now relies. These findings were also approved by the Court below (279 F. 2d at pp. 156-7) (R. 46). Thereunder, the payment of cash, *per se*, has no effect upon accrual; and where, as here, a *bona fide* contest of the tax liability exists, the involuntary payment of the $15 is *not* an expense item but "is chargeable to a suspense, deferred debit or other receivable account", (Finding No. 38, Appendix III, p. 56, *infra*) and the accrual of any part of the $15 as an expense must await the outcome of the litigation. Thus, Respondent's position in the present case, that the legal principles of income tax accrual which this Court established in *Anderson* and *Dixie Pine*, place the emphasis upon the denial and contest of the liability, and not upon the involuntary payment during the contest, is in complete accord with the recognized accounting principles relevant to the accrual basis. It would go counter to the history and purpose of the federal income tax laws and to the declared intent of Congress and Treasury to create an unnecessary disparity between the two, as the Government seeks to do in the present case.

Administrative Considerations Support, Rather Than Militate Against, Congruency in the Present Case, of the Statutory Concept of Accrual With Recognized Accounting Principles

Since taxes are the "life blood" of Government,[54] one of the cardinal principles of tax administration is that the maximum revenue be determined and collected at the earliest point of time. To that end, the tax collector is interested

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[52] Appendix II, pp. 55-57, *infra*.

[54] *Bull* v. *United States*, 295 U. S. 247, 259.

in accelerating income and postponing deductions. Respondent's position accomplishes this purpose, whereas the Government's position would defeat it. The Government would accelerate, rather than postpone, deduction of the $15 and thereby forego immediate increased tax receipts. This attitude is reminiscent of the pre *Dixie Pine* days when, regardless of principle, the Commissioner took whatever position protected the revenue in a particular situation.[55] In addition to allowing a deduction for a tax liability which may not even exist,[56] it would also compel the Government to underwrite the future solvency of taxpayers by allowing them immediate deductions of contested local tax liabilities and then relying upon their restoration to income at some undetermined future date.[57]

The Government's contention (Br. 24) that payment is a "readily determinable" event upon which to predicate accrual ignores the fact that a *bona fide* contest of liability is an equally "readily determinable" event for that purpose. The contention also evades the real issue in this case; namely, which of these two events—the contest of the liability or the involuntary, compulsory payment—is to prevail under the income tax accrual concept defined by this Court (*Anderson, Dixie Pine, Security Mills* and *Lewyt*); and is but a repetition of the taxpayer's argument in *Dixie Pine* that the denial and contest of the asserted tax liability is not the critical event for purposes of accrual—an argument which this Court rejected (see pp. 14-17, *supra*).

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[55] The Commissioner's position in the present case is prompted by the fact that, because of the gradual increase in corporate income tax rates (normal plus surtax) from 38% in 1946 to 50¾% in 1951, it produces more revenue in this particular instance to have the deduction taken in 1946-1950 rather than in 1951.

[56] The administrative objections to this situation apply with equal force in the present case as they did to the disallowance of the deduction for interest on a contested tax liability, as outlined in *G. C. M. 9575*, X-1 C. B. 381, 383.

[57] The situation contemplated by Section 22(b)(12) to which the Government refers (Br. 31) is based upon the premise that the deduction was *properly* taken in the prior year. *Streckfus Steamers, Inc.*, 19 T. C. 1 (Acq. 1953-1 C. B. 6).

The Government advances as a further practical consideration the possibility of "calculated tax evasion" and manipulation by taxpayers of local tax controversies, quoting at length from the dissenting opinion below (Br. 25-26). This objection was fully answered by the Court below as follows (R. 47)[58]:

> "It is suggested in criticism of our decision that it leaves open to a taxpayer opportunities for manipulation through self-serving appraisals. Such opportunities are no greater when payment has been made under protest to prevent the attachment of liens or seizure, than when payment has not been made, as in the Dixie Pine case. The problem of determining whether the contest is a bona fide one is present in either situation. The criticism, we think is really directed against the Dixie Pine line of decisions."

Furthermore, with due respect, we submit that such an objection does not fully envisage the realities of the situation. Any "expedient" manipulation[59] to which the "great corporations" might resort, as charged by the Government and the dissenting Judge in the Court below, would redound to the benefit of the Government rather than to the corporations. By "postponing" the deductions, such "manipulating" taxpayers would be immediately out of pocket the resultant increase in tax (aggregating over $3¼ million in the present case) during the "indefinitely" postponed period (from 1 to 5 years in the present case) while the Government would have the use of that money, interest free. Is it reasonable to assume that such taxpayers would gamble that a future increase in tax rates[60]

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[58] *Consolidated Edison Company of New York* v. *United States*, 279 F. 2d 152, 157.

[59] Certainly, the unilateral payment of a contested tax liability during the contest, lends itself more readily to manipulation than does the bilateral settlement with the local tax authorities of a *bona fide* contest. In the present case the settlement of the contested real estate tax liabilities produced a refund of about $2½ million from the City of New York.

[60] What if the rates are reduced!

would exceed the resultant interest loss; or that a future net operating loss, after applying the carryback and carryforward loss provisions of the Code, would leave an unabsorbed portion in excess of the interest lost on the increase in tax originally paid?

The Commissioner's Administration of the Question Presented Herein Has Been Vacillating and Inconsistent. His Reliance Upon *G. C. M. 25298* Is a Bootstrap Attempt and Is Contrary to Its Subsequent Modification in *Mim. 6444*.

The Commissioner's reliance upon *G. C. M. 25298*, C. B., 1947-2, 39 in the present case is really an attempt to raise himself by his own bootstraps; for that was the very ruling issued to Respondent on the very question now before this Court.

The Commissioner had refused to accept or follow *Chestnut Securities*[61] until, some two years later, when he was confronted with Respondent's claims for refund for the years 1938, 1939, and 1941. Pursuing a revenue protection course, the Commissioner ignored *Chestnut Securities* with respect to the year 1938 and 1939 (and in the terms of the illustrative example, allowed $95 as a deduction), but seized upon *Chestnut Securities* to deny the 1941 claim for refund (with respect to the $5) and issued to Respondent the aforementioned ruling, which was later published as *G. C. M. 25298*. This ruling was just another step in the vacillating and inconsistent positions the Commissioner has taken on the question presented herein.[62] Respondent however, has consistently maintained its present position that contested items are non-accruable and non-deductible until the termination of the controversy, but was constrained to file its returns for 1946-1951 pursuant to the instructions of

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[61] Acceptance of an adverse court decision was, at that time, indicated by publishing it in the Cumulative Bulletin, or by a published G. C. M. or I. T. Nowadays, it is indicated by a published TIR or Rev. Rul.

[62] See pp. 8-9, *supra*, and Appendix III, pp. 58-61, *infra*.

the Commissioner addressed to it in the aforementioned ruling. The Government improperly implies (Br. 6, 7, fn. 1, 12) inconsistency on the part of Respondent because of this compliance.

Some two years later, the Commissioner modified *G. C. M. 25298,* and ruled that the payment of a contested tax "which is required as a prerequisite for further appeal", as distinguished from a payment to avoid penalties or interest,[63] was "not to be regarded as payment of a demanded tax deficiency". *Mim. 6444,* C. B. 1949-2, 11. The only apparent distinction between the two types of tax payments referred to in *Mim. 6444* is that one is a compulsory or involuntary payment and the other is a non-compulsory or voluntary payment.[64] Fundamentally, there is no difference between the compulsory payment to prevent the seizure and foreclosure of property under the New York law and the compulsory payment in *Mim. 6444.* In both situations an element of duress, is present. If, as a matter of law, payment *per se* is insufficient to accrue the contested tax liability in *Mim. 6444,* it is also insufficient to accrue the contested tax liability in the present case. Indeed the Government recognizes the conflict between the two rulings (Br. 30, fn. 14) but attempts to minimize it by claiming it was issued prior to the decision of the Court of Claims in the *Consolidated Edison* case, and also implies that the Commissioner overruled *Mim. 6444* by his acquiescense in *Lehigh Valley Railroad Co.,* 12 T. C. 977.

The fact that *Mim. 6444* was issued prior to the Court of Claims decision in the *Consolidated Edison* case (and

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[63] It should be observed that nothing is said about avoiding seizure and foreclosure of property.

[64] It has already been noted that under the New York law the involuntary payment of the $15 was a compulsory payment to avoid seizure and sale of property by foreclosure of the tax lien pending appeal to the State court from the adverse administrative ruling of the City Tax Commission. See p. 4, *supra.*

it is still outstanding) is merely additional proof of Respondent's statement (p. 15, *supra*) that the Commissioner often fails to follow his own ruling when it is in the interest of the revenue to do so.[65] And the reference to the Commissioner's acquiescence in *Lehigh Valley* is additional proof, if such be needed, that the Government has completely misread the *Lehigh Valley* case on this point. See discussion of that case at pp. 46-49, *infra*.

POINT III

The authorities upon which the Government relies are contrary to the principles of accrual established by this Court; and do not support the Government's contentions.

The Government relies primarily upon *Chestnut Securities Co.* v. *United States*, 104 C. Cls. 489, 62 F. Supp. 574; and *Consolidated Edison Co. of New York, Inc.* v. *United States*, 133 C. Cls. 376, 135 F. Supp. 881. These decisions, we submit, are contrary to the principles of accrual established by this Court; are themselves contradictory; and are also contrary to the decisions of other Courts on similar and related matters.

The Chestnut Securities Doctrine—"Accrual Does Not Survive Payment"

The theory that payment of an unadmitted and contested tax liability, in and of itself, accrues the liability, was first enunciated in *Chestnut Securities*. There, contested state taxes for the years 1936, 1937, and 1938 were held accruable and deductible, under Section 23(c), in 1940, the year they were paid, rather than in 1942, the year the contest was finally terminated. The taxpayer in

[65] The Commissioner, in *Lehigh Valley*, had also failed to follow his own ruling and the Tax Court made specific reference thereto. See fn. 2 at p. 998.

that case distinguished *Dixie Pine* on the ground that in *Dixie Pine* the tax had not been paid. Admitting that payment would have been controlling in the case of a cash basis taxpayer, the Government maintained that it was irrelevant in the case of an accrual basis taxpayer.

In answer thereto, the Court of Claims stated (104 C. Cls. at pp. 494-95):

> "We think the Government is wrong. One is not entitled to accrue a debt or other liability which is asserted against him but which he disputes and litigates, until the litigation is concluded. But if a liability is asserted against him and he pays it, though under protest, and though he promptly begins litigation to get the money back, the status of the liability is that it has been discharged by payment. It is hardly conceivable that a liability asserted against him, which he has discharged by payment, has not yet 'accrued' within the meaning of the tax laws and the terminology of accounting. *Accrual*, from the debtor's standpoint, *precedes payment, and does not survive it.*"

and after observing that in *Security Mills* the tax had not been paid,[66] continued:

> "In the instant case the taxpayer denied liability but paid. We think it thereby accrued the taxes and

[66] The Court, however, overlooked the fact that, under the Oklahoma law, the contested tax paid in *Chestnut Securities* was placed in a special account to await the outcome of the litigation, just as in *Security Mills* the contested tax was, under Court order, paid to a designated depository to await the outcome of the litigation. The Court of Claims may nevertheless have reached the correct result, because the decisions of this Court in *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 33, 57-58 and *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435 which were followed by the District Court in 1940, in deciding that Chestnut Securities was liable for the contested state excise taxes, could well have been the basis for concluding that the taxpayer's subsequent appeals were merely pro forma and that the continued litigation was unwarranted and not *bona fide*.

> interest, *if accrual is requisite at all*, in the case of a debtor when actual payment has occurred."

The doctrine, "Accrual * * * precedes payment and does not survive it", was obviously based upon the court's belief that it was "within the meaning of the tax laws and the terminology of accounting"—beliefs which the Government completely ignores. Both of these beliefs were subsequently proven erroneous.

The phrase "if accrual is requisite at all", indicates that Court believed "paid or accrued", as used in Section 23(c), could be read in the alternative to permit an accrual basis taxpayer to take the deduction in the year of payment.[67] It was unnecessary to decide this question at that time since the same result was obtained under the doctrine that accrual does not survive payment. That belief, however, became the basis of the Court of Claim's decision in a later case[68] which was reversed by this Court. *United States* v. *Olympic Radio & Television, Inc.*, 349 U. S. 232.

The question whether the *Chestnut Securities* doctrine was "within the terminology of accounting" was squarely put in issue in the *Consolidated Edison* case filed in the Court of Claims. The specific findings of the Court of Claims thereon contradict *Chestnut Securities* and unequivocally hold that accrual *does* survive payment.[69]

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[67] In fact, *Chestnut Securities* was cited for this principle in a dictum in *Baltimore & O. R. Co.* v. *Magruder*, 77 F. Supp. 156, 169-170, cited by the Government (Br. 20). See discussion thereon at p. 50, *infra*.

[68] *Olympic Radio & Television, Inc.* v. *United States*, 124 C. Cls. 33, 110 F. Supp. 600.

[69] Findings numbered 35 to 38 inclusive, 133 C. Cls. 376, 397-98; and findings numbered 44, 45 and 46 with respect to the proper book entries in terms of the illustrative example. For convenience and ready reference, these findings are reproduced in Appendix III, pp. 58-61, *infra*.

The Court explained its failure to follow these findings because they "represent a refinement in ascertaining net income that would be impractical, and, in our opinion, infeasible in the administration of the revenue laws" (133 C. Cls. at p. 384).[70] No such claim was made by the Government nor was there anything in the record to even suggest it. And, of course, it is contrary to the intent of the accounting provisions of the Internal Revenue Code. See pp. 31-33, *supra*.

The "Otherwise Accruable" Doctrine Enunciated by the Court of Claims in the *Consolidated Edison* case.

The decision of this Court in *Olympic Radio*, reversing the Court of Claims decision that "paid or accrued" may be read in the alternative, was handed down just before reply briefs were due in the Court of Claims *Consolidated Edison* case. Confronted with this reversal and with its own findings that accrual *does* survive payment, the Court of Claims purported to adhere to *Chestnut Securities*,[71] but actually veered away from it, saying (*Idem* pp. 383-384):

> "What we have said does not mean that the mere payment of an item accrues that item * * *"

and then proceeded to expound an entirely new doctrine:

> "* * * but rather we hold that payment of an item which is *otherwise accruable in the taxable year* accrues the item even though payment is made under protest and even though litigation is started within the taxable year to obtain repayment."

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[70] The Court of Claims, itself, recognizes that questions of administrative impracticality in administering revenue laws are more properly matters for Congress to determine. *North American Van Lines* v. *United States*, 169 F. Supp. 252, 256.

[71] "In our opinion the rule stated in the *Chestnut Securities* case is applicable in the instant case." (133 C. Cls. at p. 381).

The court did not clarify whether "otherwise accruable" meant "otherwise accruable but for the payment" or "otherwise accruable but for the contest". Since *payment* was the crux of *Chestnut Securities*, upon which the Court relied, it is probable that it meant "otherwise accruable but for the payment". If so, the doctrine is clearly erroneous because, under *Dixie Pine*, the contested $15 was not accruable during the pendency of the litigation until it was completed in 1941 and, therefore, not "otherwise accruable" when the payment was made in 1939. If it meant "otherwise accruable but for the contest" the decision is contrary to *Chestnut Securities* where, but for the contest, the taxes would have accrued in 1936-1938, the years *for which* they were assessed, and not in 1940, the year the deduction was allowed;[72] and, of course, it ignores the basic and underlying concept of the contested liability test of *Dixie Pine*.[73]

The Court of Claims Decisions Are Contrary to the Decisions of Other Courts on This Question and on Related Matters

Less than a year after the Court of Claim's decision in the *Consolidated Edison* case, the question whether payment, *per se*, accrues an unadmitted and contested tax liability was, for the first time, passed upon by a court other than the Court of Claims in *Standard Oil Company* v. *United States*.[74] There, the taxpayer, while denying and contesting its liability for excise taxes on sales made in 1932 and 1933, paid the disputed taxes in 1937. The tax-

[72] In its Court of Claim's case, Consolidated Edison Company, emphasizing that payment is irrelevant for purposes of accrual, called the court's attention to the fact that if the Commissioner were correct and payment governed accrual, he should have allowed a deduction of the entire 1941-1942 City real estate tax instead of only the first half of the tax, because the Company had paid the entire tax in 1941, the second half of which was payable in 1942.

[73] See discussion at pp. 14-17, *supra*.

[74] 51 AFTR 1688; 56-2 USTC (CCH) Par. 10051.

payer finally lost the contest in 1947. The Government argued that, under the Court of Claims decisions in *Chestnut Securities* and *Consolidated Edison*, the taxpayer could take a deduction for the excise taxes only in 1937, the year of payment. After reviewing the *Dixie Pine*, *Security Mills*, *Chestnut Securities* and *Consolidated Edison* decisions, the District Court of Ohio held otherwise, saying:

> "This rule [of the Court of Claims] is not the same rule that was announced in the *Dixie Pine* case, though the court [of Claims] claims that it is."

and later concluded:

> "* * * the rule to be uniform should follow the straight rule laid down in *Dixie Pine* and *Security Flour* that all events do not occur within the taxable year that fix the amount and the fact of tax liability until litigation is ended. After all, payment is not really one of the events which fix the amount or the fact of tax liability, and the final adjudication is the last of those events."

The Government did not appeal that decision.

In the present case, the court below considered the Court of Claim's decisions in *Chestnut Securities* and *Consolidated Edison* in the light of the decisions of this Court in *Anderson, Dixie Pine, Security Mills,* and *Lewyt;* and in a well reasoned opinion concluded "with due respect we disagree with this view" of the Court of Claims that accrual precedes payment and does not survive it (R. 46). And more recently the 8th Circuit cited the decision of the Court below with approval as representing the converse, from the income viewpoint, of the principle which it decided in *Schlude* v. *Commissioner,* 283 F. 2d 234, 238, cert. applied for, January 4, 1961.

The Government's reference to the "claim of right" doctrine as supporting its position (Br. 23-24), ignores the fact that the doctrine is, among other things, a reve-

nue protecting departure from recognized accrual concepts —that a taxpayer, claiming and actually receiving the claimed income, should pay the tax thereon while it has the money to pay it rather than have the Government await the outcome of litigation *subsequently* commenced, or of an appeal subsequently taken, by one other than the taxpayer —by which time the taxpayer may have become insolvent and the tax uncollectible. The position of Respondent herein is supported by the equally cogent considerations and solicitude for the protection of the revenue which underlie the "claim of right" doctrine.[75] But more than that, it is the "disclaimer of right" doctrine—not the "claim of right" doctrine—that is analogous or the converse of the situation in the present case.

In *Sohio Corporation* v. *Commissioner*, 163 F. 2d 590, a purchaser of oil at the producer's well head was required, by State law, to collect the State tax imposed upon the producer by withholding it from the price and turning it over to the State less 2% for collecting the tax. The taxpayer sued to have the law declared unconstitutional. Meanwhile, as required by the statute, it withheld the tax on the oil it purchased and turned it over to the State less the 2%. In upholding the taxpayer's failure to report the 2% as income, the Court of Appeals for the District of Columbia stated (p. 593):

> "* * * we do not think that when a taxpayer is compelled by a state authority, over his protest, to retain possession temporarily of funds, he can be charged with having income on that account. The cases of Dixie Pine * * * and Security Flour * * *

[75] Although the "claim of right" doctrine falls within the broad category of income tax accrual, it is going pretty far afield to attempt to apply that doctrine to the "narrow issue" presented in this case. Moreover the most recent decision thereon does not support the Government's application of the claim of right doctrine. *Schlude* v. *Commissioner*, 283 F. 2d 234, cert. applied for January 4, 1961.

> dealt with deductions from income and held that a taxpayer may not accrue an expense the liability for which is contingent and is contested by the taxpayer. The problem in the present case concerns income rather than a deduction, but we think that the same principle applies. If, as a matter of law, a deduction is not accruable if the liability is contingent and contested by the taxpayer, similarly income is not accruable if the right thereto is contingent, being denied and contested by the taxpayer."

and:

> "We hold that where a taxpayer was compelled by a state law, under threat of heavy penalties and over its formal and repeated protest, to withhold from its vendors portions of its contract purchase price, and promptly contested in the courts the compulsory withholding, it had not received income by reason of this withholding."

See also *Bates Motor Transport Lines Inc.*, 17 T. C. 151, 158-59, aff. 200 F. 2d 20, 23-24 where the taxpayer failed in its proof as to the *amount* of the disclaimed receipts that were properly excludable from gross income.

The *Sohio* and *Bates* cases lend support to Respondent's position herein. Just as the denial of the right to the monies warrants their non-accrual, for income tax purposes, even though the monies were actually but involuntarily received, so does the denial and contest of asserted tax liabilities warrant their non-accrual, for income tax purposes, even though the liability was actually but involuntarily paid while denying and contesting the obligation therefor.

The Other Cases Cited By The Government Fail to Support Its Claim In The Present Case

Quoting from *Chestnut Securities* that accrual does not survive payment, the Government states (Br. 19) that "[t]he Tax Court has reached the same conclusion", and cites *Lehigh Valley R. R. Co.*, 12 T. C. 977; *Western Cart-*

ridge Co., 11 T. C. 246, 267-268; and also *Baltimore & O. R. Co. v. Magruder*, 77 F. Supp. 156, 169-170, aff'd 174 F. 2d 896. We respectfully submit that none of these cases called for the application of the *Chestnut Securities* doctrine, and that they fail to support the Government's contention.

In *Lehigh Valley* the Court summarized the complicated facts as follows (p. 995):

> "During the years 1932-1940, the State of New Jersey assessed in each year taxes on the petitioner's property located in that state. The petitioner paid in each of the years, before the due date, a portion of the taxes assessed for which it admitted liability [about 50% of the assessed tax], and contested in the courts the amount unpaid * * *
>
> "During the progress of the litigation, the petitioner paid additional amounts to the State of New Jersey in conformity with restraining orders of the United States District Court, requiring it to bring its payments on account of taxes up to a prescribed percentum of the tax originally imposed for the respective years. (At first the requirement was 50 per cent, this was later increased to 60 per cent, and finally to 70 per cent, of the tax originally assessed.) *Thereafter the amounts which were unpaid remained in controversy.*"

and (p. 999):

> "The record shows that the litigation as to the amounts of the taxes imposed for 1932-1933 which were unpaid and in controversy was terminated on April 17, 1939, * * * The litigation as to the amounts of the 1934-1936 taxes, unpaid and in controversy, was terminated April 28, 1941, * * * Thereafter, on August 4, 1941, the petitioner discontinued its appeals in the 1937-1940 cases."

The taxpayer urged that the final 30% of the unpaid and contested New Jersey taxes accrued and were deductible in the respective years the contests ended, 1939 and 1941; and that such deductions produced net operating

losses which, when carried forward to the following two years, wiped out the proposed deficiencies for those years. To avoid any confusion as to whether *Chestnut Securities* was or was not correct or applicable, counsel for taxpayer, in his opening statement specifically limited taxpayer's contention of non accrual to the final 30% of the asserted taxes, and conceded that 20% of the asserted taxes which were paid during the contests, accrued in the years paid, under *Chestnut Securities.*[76]

The Commissioner, pursuing a revenue protection course, maintained contrary to his own published ruling,[77] that the tax liabilities accrued in each of the earlier years *for* which they were assessed, because the contests were only of the *amounts* of the liabilities and not of the *fact* of liability; therefore, there were no available net operating loss deductions in 1941, 1942 and 1943 to wipe out the proposed deficiencies.

In deciding the issue before it—accrual of the 30% of the unpaid and contested taxes—the court said (p. 999):

> "In our judgment, the unpaid amount of the taxes imposed in each of the years 1932-1940, which was contested in the courts, was so contingent and uncertain as to make accrual improper until the termination or discontinuance of the litigation. We hold, therefore, that the amounts of 1932-1933 taxes which were unpaid and in litigation on January 1, 1939, accrued in 1939; that the amounts of the 1934-1936, and the 1937-1940 taxes which were unpaid and in

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[76] With respect to the deduction of the 20% in the years paid, counsel for the taxpayer said (p. 22 of transcript of testimony):

> "* * * we can get no benefit from it even though the contest was thereafter continued. We are willing in this case, in order to simplify the issues, to acquiesce in the doctrine of Chestnut Securities case, that payment is tantamount to an accrual, even though the contest be continued."

[77] The judge called specific attention to the fact that Commissioner's position was contrary to his own ruling. See fn. 2, p. 998.

litigation on January 1, 1941, accrued in 1941. *Lucas v. American Code Co., supra; Dixie Pine Products Co. v. Commissioner, supra; Security Flour Mills Co. v. Commissioner, supra.*"

and in connection with the concession made by the taxpayer's attorney regarding the 20% of the asserted tax paid during the contest, the court, in a dictum, continued (p. 999-1000):

> "We hold, further, that amounts of the unpaid and contested taxes which were paid from time to time during the progress of the litigation accrued and were deductible from gross income in the respective years when paid."

The acquiescence in *Lehigh Valley*, referred to by the Government (Br. 30, fn. 14), was in the decision of the Court on the issue before it—which the Government overlooks—and not in the above quoted dictum which the Government refers to and quotes in footnote 9 (Br. 19-20). The failure of the court to cite the *Chestnut Securities* case clearly indicates that the court itself was of the opinion that the *Chestnut Securities* doctrine was not in issue before it.

In *Western Cartridge*, the taxpayer's 1942 state income tax returns disclosed a tax liability of some $562,000 which it paid simultaneously with the filing of the return in 1943. It reserved the right to file an amended return when renegotiation of Government contracts were concluded. Upon conclusion of the renegotiation in 1944, the taxpayer filed an amended 1942 state tax return disclosing the resultant reduced income from the Government contracts and filed a refund claim of some $320,000 upon which no action had been taken by the time the Tax Court case was tried.

In its 1942 federal income tax return, the taxpayer took a deduction for state income taxes of about $572,000 which the Commissioner allowed. The Commissioner then sought to relate back to 1942 the result of the renegotiation agree-

ment and reduce the state income tax deduction by some $318,000, which the Tax Court overruled. This ruling does not involve the application of the *Chestnut Securities* doctrine that payment accrues a contested liability; it merely presents an *Anderson* situation where a taxpayer, by self assessment, pays a 1942 uncontested tax liability when due in 1943. Had the Tax Court applied the doctrine that payment accrues a contested liability, it would have had to allow the state tax deduction of the state taxes in 1943, the year they were paid, instead of allowing the deduction in 1942.

In the *Baltimore & Ohio* case, the taxpayer, on the accrual basis, did not pay the tax imposed by the Carrier's Taxing Act and sued to have the Act declared unconstitutional. The District Court, following *Dixie Pine*, upheld the Commissioner's disallowance of the taxpayer's deduction of those taxes. In distinguishing that case from those where other railroads contested but paid the Carrier's tax, the Court, citing *Chestnut Securities*, stated (77 F. Supp. at pp. 169-170) that those other railroads "are in an entirely different situation, because having actually paid the tax, the amount so paid undoubtedly constitutes 'taxes paid • • • within the taxable year' as provided in section 23(c) • • • and, therefore, the question of whether a deduction for taxes has 'accrued' within the meaning of that section is not involved." This statement, upon which the Government relies, in addition to being dictum, cites *Chestnut Securities*, not for the proposition that accrual does not survive payment, but for the proposition that section 23(c) is to be construed in the alternative to permit a taxpayer to take a deduction either for taxes paid or taxes accrued, a construction rejected by this Court in *Olympic Radio*. See discussion thereon at pp. 40-41, *supra*.

POINT IV

The right to a refund of part of a contested and involuntarily paid tax, as determined by a later settlement of the contest, does not constitute income in the year of settlement.

It follows, from Respondent's argument in Point I, that its right to the refund of the $5, established by the settlement in 1951, did not constitute taxable income in 1951[78]. The payment of the $15 was a balance sheet transaction which had no income tax consequence and which was held in suspense, for income tax purposes, pending the outcome of the contest proceedings. The return of the $5 was a reversal, to that extent, of that transaction—and similarly had no income tax consequence.

The fact that Respondent was improperly allowed a deduction in 1949 of the contested $15, of which the $5 was a part, does not warrant taxing as income the $5 refund in 1951. Under the annual accounting system of our income tax laws, each year is separate and independent, and stands on its own feet. If an error is committed with respect to a taxpayer's income tax liability for a year that is closed by the statute of limitations, it may not be rectified by adjusting that taxpayer's income tax liability for another year. Congress has expressed its intent "to require re-

[78] The Government's argument in Point II of its brief (Br. 30-31) that the $5 constitutes taxable income in 1951 is similarly based on the assumption that it is correct in its argument that the $15 accrued and was *properly* deductible under Section 23(c) in 1949. In *Rothensies* v. *Electric Storage Battery Co.*, 329 U. S. 296, cited by the Government, the taxpayer admitted, and had not contested, its liability for the excise taxes; and had *properly* accrued and deducted them in the year of assessment. The subsequent refund of that tax was therefore includable in gross income because it was a refund of an item which had been *properly* deducted in a prior year. This, too, is the underlying basis of the tax benefit rule embodied in Section 22(b)(12).

fund to the taxpayer of an overpayment, even though he has failed to pay taxes for other periods, whenever their collection is barred by limitation". *McEachern* v. *Rose*, 302 U. S. 56, 62. Respondent, having overpaid its 1951 income tax by erroneously including the $5 in its income, is entitled to its refund regardless of the fact that $15 (of which the $5 was part) was erroneously allowed as a deduction in Respondent's return for 1949 which is now closed by the statute of limitations. *Commissioner* v. *Dwyer*, 203 F. 2d 522, 524-525; *Streckfus Steamers, Inc.*, 19 T. C. 1.

Any relief or remedy available to the Commissioner with respect to Respondent's $15 deduction in 1949, in the event of a decision in Respondent's favor in the present case, is specifically provided in Sections 1311-1315 of the Internal Revenue Code of 1954. Thereunder, the statute of limitations for the year 1949 is opened up for one year after a decision herein in favor of Respondent becomes final, within which the Commissioner may assert a deficiency for 1949, with respect to the $15 in accordance with the provisions in said Sections 1311-1315.

POINT V

The decision and judgment of the Court below should be affirmed.

Respectfully submitted,

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APPENDIX I

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * *

(c) *Taxes generally.*—

(1) Allowance in general—Taxes paid or accrued within the taxable year, * * * [with exceptions not material here].

* * *

(26 U. S. C. 1952 ed., Sec. 23)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.

* * *

(26 U. S. C. 1952 ed., Sec. 41)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable years in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

* * *

(26 U. S. C. 1952 ed., Sec. 42)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the dividends paid credit provided in section 27) provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

* * *

(26 U. S. C. 1952 ed., Sec. 43)

SEC. 48. DEFINITIONS.

When used in this title——

* * *

(c) *Paid, Incurred, Accrued.*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * *

(26 U. S. C. 1952 ed., Sec. 48)

APPENDIX II

Findings with respect to the applicable accounting principles in Consolidated Edison Company of New York v. United States, 133 Ct. Cls. 376, 397-398 and 400-401.

35. The accrual method of accounting as recognized by well-established principles of accounting is fundamentally different from the cash basis of accounting. Under a strict cash basis, transactions and events are not recorded until cash has been received or paid, without regard to the period to which they relate or the period in which the revenues or expenses apply. The accrual method, however, is based upon the principle of recording transactions and events as they occur, regardless of when the cash receipts and disbursements part of the activities takes place. Revenues are accrued as nearly as practicable to the period earned, and expenses, which include taxes, are accrued and allocated in as reasonable and consistent a manner as possible in the period and against the revenues they helped to produce. The primary purpose of accrual accounting principles is to obtain a proper and fair determination of periodic income, often referred to as the process of matching costs against revenues, so that in each accounting period there will be deducted all the ascertainable costs necessary to produce the revenue, including indirect period costs such as depreciation, taxes and interest.

36. Under the accrual method of accounting, the payment of cash extinguishes a liability that either has already been recorded for purposes of determining income or is yet to be recorded for purposes of determining income, but it does not of itself have any effect upon the determination of income. It may either precede or survive the accrual or recordation and is a balance sheet transaction which reduces the cash asset and is balanced by a corresponding reduction of a liability or the substitution of another asset in its place, but it has no effect on the profit or loss—the income determination.

37. When the term "accrual" is used in a balance sheet sense, as distinguished from an income-determining sense, it could never survive payment because payment extinguishes the liability and eliminates it from the balance sheet. But in an income-determining sense, payment has no effect upon accrual which may or may not survive payment depending upon whether the payment is in extinguishment of a liability already accrued or in prepayment of a liability to be incurred, determined, or accounted for at a later date or period.

38. Under accrual accounting, when payment is made with respect to a liability which is denied in whole or in part, the accounting principle as to charges against income would be the same as if payment had not been made; such payment would not affect the treatment of any accruals. This principle applies equally to the payment of taxes. The payment of the admitted or estimated ultimate liability constitutes the payment of a current charge or expense of operations and the balance of that payment represents an amount estimated to be ultimately recovered and is chargeable to a suspense, deferred debit, or other receivable account. The latter item represents an asset—a deposit which is expected to be recovered.

* * *

44. The proper book entries of this example, according to well-recognized and sound principles of accrual accounting, and in accordance with the Uniform Systems of Accounts prescribed by the P. S. C. are illustrated by the following set of entries:

1939

(1)	Dr. Tax expense	$85.00	
	Cr. Taxes accrued		$ 85.00
	(To record the admitted liability for taxes for the year 1939)		
(2)	Dr. Taxes accrued	85.00	
	Deposit for contested taxes	15.00	
	Cr. Cash		100.00
	(To record payment of the assessed tax, part of which is contested)		

	1941		
(3) Dr. Cash		5.00	
Tax expense		10.00	
Cr. Deposit for contested taxes			15.00
(To record final settlement of the contested taxes.)			

45. Under the generally accepted and well-recognized principles of accrual accounting, the $15 in this example, which the plaintiff paid over and above its admittedly liability of $85 for taxes in 1939, and which in the best judgment of management would be recovered as soon as full legal proceedings were consummated, would constitute an asset until August 1941 when the settlement was made, and when for the first time the plaintiff had knowledge that instead of an asset of $15 it had only an asset of $5, and that the remaining $10 was, instead, an expense.

46. Under these accrual accounting principles, the $10 expense is accrued and deducted in 1941 and is not related back to 1939 because accrual accounting principles are based, among other things, upon reasonableness and practicability. Under accrual accounting it would be considered unreasonable and impractical to go back and reopen closed years, the income of which had been determined upon an appraisal of all facts then known. Subsequent developments are taken into consideration and recorded in the year when they occur. If they occur immediately after the end of the year involved and before the books for that year are closed (it usually takes about 30 days to close the books of a substantial business that are kept on an accrual basis), the same practical approach would prompt taking those events into account in the prior year—but aside from this exception, under accrual accounting principles, the facts and developments are recorded in the year they occur.

APPENDIX III

Chronology of published rulings reflecting the changes in Commissioner's official position with respect to the income tax treatment of contested tax liabilities.

1920—*O. D. 741*, C. B. 3, 15—import duties erroneously paid in 1915-1917 and refunded in 1919, are not taxable in 1919, but were improperly deducted in 1915-1917.

1926—*S. M. 4683*, C. B. V-1, 59—an unconstitutional State tax law is a nullity; payments thereunder are not deductible.

1931—*I. T. 2578*, C. B. X-1, 119—a State tax law declared unconstitutional by the State Court is a nullity. A payment thereunder is not deductible for Federal income tax purposes even though Federal Court has not passed on its constitutionality. Refund of said erroneously paid tax is not taxable income.

1931—*G. C. M. 9575*, C. B. X-1, 381—interest on a contested tax liability does not accrue during the contest.

1931—*G. C. M. 9774*, C. B. X-2, 137—State franchise taxes accrue in the year in which the income, on which they are based, is earned and not in the year in which they become due and payable.

1932—*Mim. 3958*, C. B. XI-2, 33—under *O. D. 741* refund of an improperly paid tax is not income; but if a properly paid tax is refunded because of a subsequent event, the refund is taxable.

1933—*I. T. 2741*, C. B. XII-2, 48—a State tax law requiring spouses, filing separate returns, to compute their State tax liability on their combined income was declared unconstitutional. Each spouse is entitled to a deduction, for Federal income tax purposes, only in the amount of State tax properly due on their respective incomes; but where the State permitted to remain unchanged the reduced tax resulting from the

losses of one spouse offsetting the income of the other, only the amount of the tax actually paid the State is deductible.

1935—*I. T. 2934*, C. B. XIV-2, 63—under *I. T. 2578*, accrual of liability to the railroad retirement fund under an Act which was declared unconstitutional, is not allowable.

1935—*I. T. 2935*, C. B. XIV-2, 91—State franchise taxes accrue in the year in which the income, on which they are based, is earned and not in the year in which they become due and payable.

1937—*I. T. 3086*, C. B. 1937-1, 77—the practice to disallow deduction of unpaid AAA taxes, later declared unconstitutional, and to allow their deduction if paid, will be continued.

1937—*Mim. 4564*—C. B. 1937-1, 93—refund of illegally collected custom duties deducted in prior year now closed by statute of limitations, is taxable as income in the year of refund. *Mim. 3958* and other such rulings are modified.

1938—*I. T. 3170*, C. B. 1938-1, 135—deduction of paid AAA taxes will be disallowed if taxpayer files a refund claim under Title VII of 1936 Act.

1941—*I. T. 3491*, C. B. 1941-2, 177—regardless of the delay in its determination, a contested tax liability accrues and is deductible in the year for which it is imposed, but the interest thereon accrues and is deductible in the year the contest ends.

1942—*I. T. 3563*, C. B. 1942-2, 115—disputed back wages due under Fair Labor Standards Act accrue in year the services were rendered, and not in the year they were determined and paid.

1944—*Dixie Pine Products Co.* v. *U. S.*, 320 U. S. 516, published in C. B. 1944, 509—a contested tax liability

does not accrue and is not deductible during the contest.

1944—*Security Flour Mills Co.* v. *Com'r*, 321 U. S. 281, published in C. B. 1944, 526—refund of part of purchase price received on a sale in an earlier year may not be related back to the year of sale.

1944—*Stanard-Tilton Milling Co.*, 3 T. C. 1026 (Issue #2), N. A., C. B. 1944, 48—refund of uncontested AAA taxes, accrued in earlier year, may not be related back to the earlier year.

1945—*I. T. 3746*, C. B. 1945, 141—disputed back wages due under Fair Labor Standards Act accrue in year the liability is finally determined. *I. T. 3563* is modified.

1947—*G. C. M. 25298*, C. B. 1947-2, 39—a contested tax liability accrues not later than time of payment, notwithstanding continuation of contest. The accrual basis of accounting relates to the deductibility of unpaid items.

1947—*I. T. 3863*, C. B. 1947-2, 141—revokes *I. T. 3491* on basis of *G. C. M. 25298*.

1949—*Stanard-Tilton* nonacquiescence withdrawn—decision acquiesced in C. B. 1949-1, 3.

1949—*Mim. 6444*, 1949-2, 11—payment of contested tax liability as a prerequisite for appeal is not deductible under *G. C. M. 25298*. A proper deduction of a tax is not affected by its subsequent invalidation, regardless of whether it was legally or illegally imposed; and the refund thereof constitutes income to the extent the prior deduction resulted in a tax benefit, unless otherwise provided by statute. This does not apply to refund of State income taxes resulting from renegotiation of Government contracts Sec. 3806). *O. D. 741* is revoked; and *Mim. 3598*, *Mim. 4564*, *I. T. 2578*, *I. T. 2741*, and *I. T. 2934* are accordingly modified.

1950—*I. T. 3999*, C. B. 1950-1, 129—revokes *I. T. 3170* on basis of *G. C. M. 25298* and *Mim. 6444*.

1950—1950-2 C. B. 4—acquiescence in *Western Cartridge Co.*, 11 T. C. 246 (1948) and *Taylor Instrument Companies*, 14 T. C. 388 (1950) holding that deductions for State taxes taken on basis of excessive profits on Government contracts which were subsequently renegotiated and profits reduced, are not to be revised by relating back the reduced profits on the Government contracts.

1951—*Mim. 6597*, C. B. 1951-1, 20—exception in *Mim. 6444* regarding revision of State taxes resulting from renegotiated Government contracts is eliminated on basis of *Western Cartridge* and *Taylor Instrument* decisions.

1953—*Rev. Rul.* 6, C. B. 1953-1, 120—on the basis of *Mim. 6444*, the adjustment of taxes paid or accrued, which is required in computing Section 102 income, is not affected by the reduction of tax liability for the year involved which results from the carryback of an operating loss of a subsequent year.

1957—*Rev. Rul. 57-105*, C. B. 1957-1, 193—in amplification of *G. C. M. 25298*, the filing of a State tax return constitutes a denial of liability for State taxes in excess of the amount shown to be due on the return. A State tax deficiency does not accrue until the amount thereof is determined by litigation or default or admission of liability therefor.

SUPREME COURT OF THE UNITED STATES

No. 357.—October Term, 1960.

United States, Petitioner, v. Consolidated Edison Company of New York, Inc.	On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[May 22, 1961.]

Mr. Justice Whittaker delivered the opinion of the Court.

Respondent brought this action in the United States District Court for the Southern District of New York to recover a claimed overpayment of federal income taxes for the year 1951. It keeps its books and files its returns on a calendar year-accrual basis. The case turns on the correct determination of the proper year of accrual and deduction of certain contested real estate taxes. Specifically, the question is whether the contested part of a real estate tax *accrued* (1) in the year it was assessed and, for the purpose—and as the only mode recognized by the local law—of avoiding seizure and sale of the property for the contested tax while the contest was pending, was "paid" by the taxpayer, or (2) in the year the contest was finally determined.

The District Court, following the holding of the Court of Claims in *Consolidated Edison Co.* v. *United States*, 133 Ct. Cl. 376, that such a "payment" of the tax "accrues the item even though payment is made under protest and even though litigation is started within the taxable year to obtain repayment," *id.*, at 383–384, held, without opinion, that the contested part of the tax accrued in the year of the "payment." On appeal, the Court of Appeals, by a divided court, held that the contested part of the tax accrued in the year the contest was finally deter-

mined, and reversed the judgment. 279 F. 2d 152. It reasoned that inasmuch as respondent was "keeping its books on the accrual basis," the contested part of the tax accrued "only when all events [had] occurred which determine[d] the fact and amount of the tax liability." *Id.*, at 155. To resolve the conflict between the decision below and *Consolidated Edison Co.* v. *United States*, *supra*, we granted certiorari. 364 U. S. 890.

During the years involved—1946 through 1950—respondent owned numerous tracts of real estate in New York City which were subject to annual local property taxes. Under the New York law, the City Council annually fixes the tax rate, and the City Tax Commission annually fixes the property valuations. Thus the amount of the tax on each tract is determined by multiplying the valuation by the tax rate. The tax rate is not contestable, but a timely application (commonly called a "protest") may be made to the City Tax Commission to correct an erroneous valuation. Among other things, the protest must state the amount which the taxpayer "consider[s] was the full value of the property on January 25 [of the current] year" thus to establish the amount of the tax that is not contested. Upon exhaustion of this administrative procedure, a review of the Commission's determination may be had by a judicial proceeding, commonly called a certiorari proceeding, in the State Supreme Court, which is the taxpayer's sole and exclusive remedy. But the institution of such a suit does not stay or suspend the maturity of the tax bill, the accrual of 7% interest on it, nor the seizure and sale of the property to satisfy the tax lien. Thus, to obtain review, the taxpayer must either "pay" the tax or suffer the interest penalty and run the risk of seizure and sale of its property.[1]

[1] The procedures allowed by the laws of New York for the contest of real property taxes are more fully set forth in *Consolidated Edison Co.* v. *United States*, 133 Ct. Cl. 376, 378.

Though taxes for each of five years on hundreds of tracts are involved and the aggregate amount is very substantial, the parties very commendably stipulated in the District Court that the facts are sufficiently reflected, for the purposes of this suit, in the following simplified example:

In each of the years 1946 through 1950, respondent was notified of a tentative valuation which, at the established tax rate, would produce a tax of $100. Respondent then timely filed a *bona fide* protest (in respect of many, but not nearly all, of its tracts) stating a valuation which, at the established tax rate, would produce a tax of $85, and asking that the balance of the proposed valuation be stricken as excessive. After hearing, the Commission rejected the protest, and an assessment in the amount of $100 was made. Thereupon respondent, under protest and for the honestly stated purpose of avoiding the interest penalty and the seizure and sale of its property while it was contesting the Commission's valuation by certiorari proceedings in the state court, remitted to the city cash in an amount equal to the tax of $100, and immediately thereafter commenced a certiorari proceeding in the proper court, in which it again admitted liability for a tax in the amount of $85, but denied all liability for any tax in excess of that amount. In December 1951, the court, upon the consent of the parties to the action, entered its order in (each of) the certiorari proceedings fixing respondent's tax liability at $95, and thereupon the city forthwith returned $5 to respondent.

Although it was then engaged in a contest with the Commissioner in the Court of Claims over an identical question, namely, the proper income tax treatment to be accorded the $15 for each of the years 1938, 1939 and 1941—which issue was decided by the Court of Claims in December 1955 in favor of the Government, *Consolidated Edison Co.* v. *United States, supra*—respondent, in

terms of the illustrative example, accrued on its books and deducted on its federal income tax returns, for each of the years 1946 through 1950, the full $100; and in its return for the year 1951—in which year the real estate tax liability was determined to be $95—respondent failed to deduct the $10 from, and included the $5 in, its gross income for that year.[2]

Believing that this treatment of the $15 in 1951 was erroneous and resulted in its paying a lesser amount of federal income taxes in each of the years 1946 through 1950, and more in the year 1951, than it should have paid,[3] respondent filed in February 1955 its claim for refund of so much of its 1951 income taxes as resulted (1) from its failure to deduct the $10 of real estate tax that was determined, in that year, to be valid, and (2) from its inclusion in gross income of the $5 returned to it in that year. Upon rejection of that claim, respondent timely brought this action in the District Court to recover the refund claimed, and obtained the result already stated.

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[2] Respondent asserts that this treatment of the $15 in its 1951 federal income tax return was made under cumpulsion of the Commissioner's erroneous G. C. M. 25298, issued directly to it in 1947 (C. B. 1947-2, 39), saying, "a contested tax liability accrues not later than time of payment, notwithstanding continuation of contest. The accrual basis of accounting relates to the deductibility of unpaid items," and that the Commissioner insisted upon that treatment, despite his modification thereof in *Mim.* 6444 (C. B. 1949-2, 11), saying in pertinent part, that "payment of [a] contested tax liability as a prerequisite for appeal is not deductible under G. C. M. 25298."

[3] The economic consequences to the parties arise from the fact that corporate income tax rates (normal plus surtax) were increased from 38% in 1946 to 50¾% in 1951, and, in this particular instance, more revenue would be produced by taking the deduction in 1946–1950 than in 1951. The taxpayer recognizes that, if its position be sustained, the Commissioner will have one year after entry of final judgment herein to reaudit the taxpayer's 1946–1950 returns and to assess deficiencies based upon deduction of the $15 in those years, in accordance with the provisions of §§ 1311–1315 of the Internal Revenue Code of 1954.

It is settled that each "taxable year" must be treated as a separate unit, and all items of gross income and deduction must be reflected in terms of their posture at the close of such year. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *Heiner* v. *Mellon*, 304 U. S. 271; *Guaranty Trust Co.* v. *Commissioner*, 303 U. S. 493; *Security Mills Co.* v. *Commissioner*, 321 U. S. 281. And the parties agree that, under the applicable federal statutes,[4] neither the Government nor an accrual-basis taxpayer may cause an item to be deducted in a year other than the one in which it accrued. *United States* v. *Anderson*, 269 U. S. 422; *Security Mills Co.* v. *Commissioner*, *supra*; *United States* v. *Olympic Radio & Television*, 349 U. S. 232. They also agree that the "touchstone" for determining the year in which an item of deduction accrues is the "all events" test established by this Court in *United States* v. *Anderson*, *supra*,[5] and since reaffirmed by this Court on numerous occasions, so that it is now a fundamental principle of tax accounting. See, *e. g.*, *Lucas* v. *American Code Co.*, 280 U. S. 445; *Brown* v. *Helvering*, 291 U. S.

[4] The applicable statutes are §§ 23 (c), 41, 42, 43 and 48 of the Internal Revenue Code of 1939 (26 U. S. C. (1952 ed.), §§ 23 (c), 41, 42, 43, 48). These provisions are the same as their counterparts in prior Revenue Acts and in the Internal Revenue Code of 1954. Inasmuch as those statutes are not really in contest in this case, it would serve no useful purpose even to abstract them here.

[5] In the *Anderson* case this Court declared the so-called "all events" test as follows: "In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in advance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on a different footing than other accrued expenses appearing on appellee's books. In the economic and bookkeeping sense with which the statute and Treasury decision were concerned, the taxes had accrued." 269 U. S., at 441.

193; *Dixie Pine Co.* v. *Commissioner*, 320 U. S. 516; *Security Mills Co.* v. *Commissioner, supra.*[6] The parties also recognize that this Court amplified, or as the Government says "added a refinement to," the "all events" test by its holding, in *Dixie Pine Co.* v. *Commissioner, supra*, that an accrual-basis taxpayer could not, while "contesting liability in the courts," deduct "the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability," but "must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated." 320 U. S., at 519. That principle was specifically reaffirmed in *Security Mills Co.* v. *Commissioner, supra.*[7]

That $85 of the $100 assessment was admitted to be owing and was intended to be paid and satisfied by the remittance, and thus accrued in the year of the remittance, is not in dispute. Respondent's good faith, in contesting $15 of the assessment, is not in dispute, for the

[6] In the *Dixie Pine* case, this Court reaffirmed the "all events" test as follows: "It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid; and this cannot be the case where the liability is contingent and is contested by the taxpayer." 320 U. S., at 519.

In the *Security Mills* case, this Court reaffirmed that test as follows: "It is settled by many decisions that a taxpayer may not accrue an expense the amount of which is unsettled or the liability for which is contingent, and this principle is fully applicable to a tax, liability for which the taxpayer denies, and payment whereof he is contesting." 321 U. S., at 284.

[7] In the *Security Mills* case, after saying "that a taxpayer may not accrue an expense the amount of which is unsettled or the liability for which is contingent," the Court concluded that "[s]ince [the taxpayer] denied liability for, and failed to pay, the tax during the taxable year 1935, it was not in a position in its tax accounting to treat the [tax] claim as an accrued liability." 321 U. S., at 284.

Government expressly "disavow[s] any suggestion that the respondent . . . filed its claims against the City of New York in bad faith, . . . calculatingly inflated those claims, or . . . failed to prosecute them with diligence." Nor is it questioned that accrual of such taxes in the proper year accords with "good accounting" principles.

But concordance of the views of the parties ends at this point. The Government contends that the remittance by respondent to the city, in each of the years in question, of cash in an amount equal to the whole of the assessed tax admitted liability for, and was intended to and did constitute "payment" and "satisfaction" of, both the disputed and undisputed parts of the assessment; and that when "the taxpayer pays the item and thereby discharges its liability, the expense has been incurred and there is no longer any contingency which would prevent its accrual." Respondent, on the other hand, insists that its remittance to the city was not intended to and did not admit liability for, nor constitute "payment" and "satisfaction" of, the contested $15 of the assessment, but was, in effect, a mere deposit, in the nature of a cash bond, required of respondent, in a practical sense, by the local law as the only available mode of avoiding the risk of seizure and sale of the property for the contested tax while its validity was being diligently contested in the only way allowed by the laws of the State.

Thus the very narrow issue here is whether the remittance admitted liability for, and constituted "payment" and "satisfaction" of, the contested part of the assessment and thereby rendered it accruable in the year of the remittance. Like the Court of Appeals, we think the respondent is right in its contention, and that $10 of the contested $15 of the tax accrued when liability in that amount was finally determined by the New York court in 1951, and that the $5, for which respondent was by

that judgment held not liable, and which was returned to it by the city, was not income to respondent in 1951.

Although the Government attempts to distinguish the *Anderson, Dixie Pine* and *Security Mills* cases on the ground that "payment" of the contested taxes had not been made in those cases, it primarily relies on the decisions of the Court of Claims in *Chestnut Securities Co.* v. *United States*, 104 Ct. Cl. 489 and *Consolidated Edison Co.* v. *United States*, 133 Ct. Cl. 376.

The *Chestnut Securities* case turned on the question whether certain judicially contested state income taxes (for the years 1936–1938) accrued when they were paid in 1940, as claimed by the accrual-basis taxpayer, or when the final judgment upholding their validity was rendered in 1942, as contended by the Government. Squarely contrary to its contention here, the Government, relying on *Security Mills Co.* v. *Commissioner, supra*, there contended that "since the [taxpayer's] accounts were kept and its tax returns made on the accrual basis, it could not take its deduction for the taxes . . . paid to the State . . . until the year 1942, when its suit for their return was finally decided adversely to it." On the facts of that case, the Court of Claims held that "the Government [was] wrong" in that contention. Although, in full consonance with the *Security Mills* case, the Court of Claims said "[o]ne is not entitled to accrue a debt or other liability which is asserted against him but which he disputes and litigates, until the litigation is concluded," it went on to say "[b]ut if a liability is asserted against him and he pays it, though under protest, and though he promptly begins litigation to get the money back, the status of the liability is that it has been discharged by payment. It is hardly conceivable that a liability asserted against him, which he has discharged by payment, has not yet 'accrued' within the meaning of the tax laws and the terminology of accounting. Accrual.

from the debtor's standpoint, precedes payment, and does not survive it." 104 Ct. Cl., at 494–495. And after pointing to this Court's use of the phrase "and failed to pay" in its holding in the *Security Mills* case that "Since [the taxpayer] denied liability for, and failed to pay, the tax during the taxable year 1935, it was not in a position in its tax accounting to treat the Government's claim as an accrued liability," the Court of Claims concluded: "In the instant case the taxpayer denied liability, but paid. We think it thereby 'accrued' the taxes and interest, if accrual is requisite at all, in the case of the debtor, when actual payment has occurred." 104 Ct. Cl., at 495.

The *Consolidated Edison* case involved the same parties, facts and questions as the present case, though in respect to earlier tax years. Although recognizing that this Court's opinions in *Security Mills Co.* v. *Commissioner, supra,* and *Dixie Pine Products Co.* v. *Commissioner, supra,* had "settled" the law to be "that a taxpayer may not accrue an expense when he is denying liability and refusing and contesting its payment," the Court of Claims rejected, as "not necessarily true," the taxpayer's argument "that there must therefore be an admission or absence of denial of liability before an item may be accrued, and that the payment of the liability within the taxable year has no effect on its accrual since payment was made under protest and litigation was immediately started to obtain a repayment" (133 Ct. Cl., at 382); and, purporting to follow, but seemingly departing from, its decision in the *Chestnut Securities* case, the Court concluded "that payment of an item *which is otherwise accruable in the taxable year* accrues the item even though payment is made under protest and even though litigation is started within the taxable year to obtain repayment." 133 Ct. Cl., at 383–384. (Emphasis

added.) On that conclusion the Court rendered judgment for the Government.

Just what the Court meant by the phrase we have italicized was not explained, but it is evident that if the tax item was "otherwise accruable in the taxable year," payment—whether of a character that would constitute an admission of the asserted liability or a mere deposit to enable contest of the liability—certainly would not render the item non-accruable; and if, in the absence of payment, the item was "otherwise accruable in the taxable year," payment would be immaterial, or at least unnecessary, to the question of accruability. It thus appears that the Court's judgment was contrary to its rule in that case, for, although it regarded the remittance as "payment" of the asserted tax liability, admittedly the contested part of the tax was not "*otherwise* accruable in the taxable year."

Disagreeing with the conclusion of the Court of Claims in the *Consolidated Edison* case, the Court of Appeals concluded, we think correctly, that the question of accruability of the tax—apart from the issue respecting "payment" and "satisfaction"—was governed by the "all events" test established by this Court in *United States* v. *Anderson*, *supra* (see note 5), as amplified and affirmed in *Dixie Pine Co.* v. *Commissioner*, *supra*, and reaffirmed as amplified in *Security Mills Co.* v. *Commissioner*, *supra*. See notes 6 and 7.

As to whether respondent's remittance of the full $100 to the city, in the circumstances of this case, constituted an admission of liability for, and a "payment" and "satisfaction" of, the contested $15 of the assessment, the Court of Appeals recognized that this Court's opinions in the *Anderson*, *Dixie Pine* and *Security Mills* cases refer to the fact that "payment" of the taxes sought to be deducted in those cases had not been made by the taxpayers, but it thought, and we agree, that those references

were made only for the sake of complete accuracy to an important but, so far as those cases were concerned, a collateral matter, and not to the determinative considerations of those cases, which were the "all events" test as they state it.

"Payment" is not a talismanic word. It may have many meanings depending on the sense and context in which it is used. As correctly observed by the Court of Appeals, "A payment may constitute a capital expenditure, an exchange of assets, a prepaid expense, *a deposit*, or a current expense," and "[w]hen the exact nature of the payment is not immediately ascertainable because it depends on some future event, such as the outcome of litigation, its treatment for income tax purposes must await that event." 299 F. 2d, at 156. (Emphasis added.)

Of course, an unconditional "payment" made by a taxpayer in apparent "satisfaction" of an asserted matured tax liability is, without more, plain and persuasive evidence, at least against the taxpayer, that "all the events [have] occur[red] which fixed the amount of the tax and determine the liability of the taxpayer to pay it," *United States* v. *Anderson, supra*, at 441, and that the item so paid and satisfied has accrued.

But where, as stipulated by the parties in this case, the remittance or "payment" did not admit, but specifically denied, liability for, and was not intended to satisfy, the contested $15 of the assessment, but was, in effect, a mere deposit, "in the nature of a cash bond for the payment of [so much, if any, of the contested] taxes [as might] thereafter be found to be due" (*Rosenman* v. *United States*, 323 U. S. 658, 662, and see *Lewyt Corp* v. *Commissioner*, 215 F. 2d 518, 523 (C. A. 2d Cir.)), and was made for the sole purpose of staying—there being no other way to stay—an otherwise possible seizure and sale

of the property for the contested tax while its validity was being honestly and diligently contested in the only way allowed by the law of the State, it will not do to say that the taxpayer has made an unconditional "payment" in apparent "satisfaction" of the contested part of an asserted matured tax liability, and thereby rendered it immediately accruable.

We therefore conclude that $10 of the contested $15 tax liability accrued not in the year of the remittance, but in 1951 when the New York court entered its final order determining that liability; and that the $5, for which respondent was held not liable by that judgment and which was returned to it by the city, was not income to respondent in 1951.

Affirmed.